Handbook of Global Economic Governance

Since the start of the global financial crisis the global economic regime has been in turmoil. Following the massive failures in financial regulation, the collapse of global trade negotiations and persistent development challenges in the wake of world-wide food and financial crises, political and public attention has been focused on the task of rethinking the fundamental ideas and rules that govern the global economy. This Handbook aims to make sense of these emerging trends. The expert authors explore the interplay of players, powers and paradigms to discern and explain key patterns of continuity and change in critical areas of global economic governance, attempting to answer a number of key questions:

- Who is playing a central role in global economic governance?
- What are the sources of material and social power that enable actors to demand or assume positions of governing authority, define agendas and write and enforce the rules of the game?
- What paradigms do these actors bring to the table?

This Handbook brings together contributions from leading scholars to analyse the governance of global trade, finance and development. Specifically, the book explores the patterns of continuity and change in the players, powers and paradigms that shape the global economy. Highlighting the multiple channels through which the ‘three Ps’ shape global governance in different areas of economic activity, the contributions in this Handbook also explore the challenges to legitimacy, relevance and effectiveness that we observe in global economic governance today.

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Handbook of Global Economic Governance

Players, power and paradigms

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Foreword

It rarely happens that well-established regimes are seriously questioned and that calls for reform prevail over the motivations for keeping the status quo. We are actually living in one of these rare moments. Since the start of the global financial crisis in 2007–08, the global economic regime has been in turmoil. Following the massive failures in financial regulation, the collapse of global trade negotiations and persistent development challenges in the wake of the global food and financial crises, political and public attention has been focused on the task of rethinking the fundamental ideas and rules that govern the global economy.

This Handbook makes sense of these emerging trends. The authors here explore the interplay of Players, Powers and Paradigms to discern and explain key patterns of continuity and change in critical areas of global economic governance. We argue that a thorough understanding of global economic governance must take into consideration the dynamic and mutually constitutive relationship that exists between these three Ps. And it is exactly such interconnectedness, which stands at the core of the architecture of global economic governance, that shapes the challenges of legitimacy, relevance and effectiveness that afflict global economic governance at different points in time.

This Handbook would not have been possible without the enthusiasm and expertise of the scholars who kindly accepted our invitation to contribute chapters. Working with them has been a pleasure and a privilege and we wish to thank them all for their unfailing support. The variety of the issues covered and the depth of analysis will certainly help students, scholars and practitioners understand the complex interrelationships that underlie the workings of the global economy and the principles, rules and practices that we may bring to bear to strengthen the legitimacy and effectiveness of global economic governance in the future.

Manuela Moschella and Catherine Weaver, 2013
Abbreviations

ACP  African, Caribbean, and Pacific countries
ACTA  Anti-Counterfeiting Trade Agreement
AfDB  African Development Bank
AIDS  acquired immunodeficiency syndrome
AM   Accountability mechanism
ARV  anti-retroviral
AsDB  Asian Development Bank
ASEAN Association of Southeast Asian Nations
AoA  Agreement on Agriculture
ATO  Alternative trade organization
BCBS Basel Committee on Banking Supervision
BIS  Bank for International Settlements
BLEU Belgium Luxembourg Economic Union
BOAD West African Development Bank
BRICS Brazil, Russia, India, China, South Africa
CABEI Central American Bank for Economic Integration
CAP  Common agricultural policy
CARE Humanitarian NGO, originally Cooperative for American Remittances to Europe
CDB  Caribbean Development Bank
CDO  Collateralized debt obligation
CDS  Credit default swap
CFS  Committee on World Food Security
CGD  Center for Global Development
CITES Convention on International Trade in Endangered Species of Wild Fauna and Flora
COGECA General Confederation of Agricultural Cooperatives
COP  Conference of the Parties
COPA  Committee of Professional Agricultural Organizations
CRS  Creditor reporting system (OECD database)
CSM  Civil society mechanism
CSO  Civil society organizations
CSR  Corporate social responsibility
DAC  Development Assistance Committee (of the OECD)
DFID Department for International Development (UK)
DIME Development Impact Evaluation Initiative (World Bank)
Abbreviations

DLI Disbursement linked indicator (World Bank)
EADB East African Development Bank
EBRD European Bank for Reconstruction and Development
EC European Commission
EC European Community
ECB European Central Bank
ECOSOC Economic and Social Council (UN)
EEA European Economic Area
ECC European Economic Community
EFSF European Financial Stability Facility
EFTA European Free Trade Association
ELA Emergency lending assistance
ELF Emergency liquidity facility
EMU Economic and monetary union
EPTA Expanded Programme of Technical Assistance
ESM European stability mechanism
EU European Union
FAO Food and Agriculture Organization
FATF Financial Action Task Force
FCL Flexible credit line
Fed Federal Reserve Board (USA)
FLO Fairtrade International
FSB Financial Stability Board
FTA Free trade agreement
FTAA Free trade area of the Americas
FUNDS Future UN Development System Project
G-7 Group of Seven
G-8 Group of Eight
G-10 Group of 10
G-20 Group of 20
G-33 Group of 33
G77 Group of 77
GAC Governance and Anticorruption (World Bank)
GATS General Agreement on Trade in Services
GATT General Agreement on Tariffs and Trade
GAVI Global Alliance for Vaccines and Immunization
GDP Gross domestic product
GEF Global Environment Facility
GF Global Fund to Fight AIDS, Tuberculosis and Malaria
GNI Gross national income
GSP Generalized System of Preferences
HD Human development
HDR Human Development Report
IAIS International Association of Insurance Supervisors
IASC International Accounting Standards Board
IBRD International Bank for Reconstruction and Development (World Bank)
ICANN Internet Corporation for Assigned Names and Numbers
IDA International Development Association (World Bank)
<table>
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>IDB</td>
<td>Inter-American Development Bank</td>
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<td>IEG</td>
<td>Independent Evaluation Group (World Bank)</td>
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<td>IF</td>
<td>Inspection Function</td>
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<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
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<td>IGO</td>
<td>Intergovernmental organization</td>
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<td>IIF</td>
<td>Institute of International Finance</td>
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<td>ILP</td>
<td>Import Licensing</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<td>IPC</td>
<td>International Planning Committee for Food Sovereignty</td>
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<td>IPC</td>
<td>Intellectual Property Committee</td>
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<td>IRM</td>
<td>Independent review mechanism</td>
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<td>ISDA</td>
<td>International Swaps and Derivatives Association</td>
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<td>IsDB</td>
<td>Islamic Development Bank</td>
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<td>ISO</td>
<td>International Organization for Standardization</td>
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<td>ITO</td>
<td>International Trade Organisation</td>
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<td>LDCs</td>
<td>Least developed countries</td>
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<td>LTRO</td>
<td>Long-Term Refinancing Operations</td>
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<td>MBS</td>
<td>Mortgage-backed security</td>
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<td>MDG</td>
<td>Millennium Development Goals</td>
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<td>Mercosur</td>
<td>Mercado Común del Sur (Common Market of the South)</td>
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<td>MFA</td>
<td>Multi-Fibre Arrangement</td>
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<td>MFIs</td>
<td>Multilateral financial institutions</td>
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<td>MFN</td>
<td>Most favoured nation</td>
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<td>MLF</td>
<td>Multilateral Fund</td>
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<td>MSF</td>
<td>Médecins-sans-Frontières (Doctors without borders)</td>
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<tr>
<td>NAFTA</td>
<td>North America Free Trade Agreement</td>
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<td>NDP</td>
<td>New Democratic Party (Greece)</td>
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<td>NGO</td>
<td>Non-governmental organization</td>
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<td>NIEO</td>
<td>New International Economic Order</td>
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<td>NIB</td>
<td>Nordic Investment Bank</td>
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<td>OCA</td>
<td>Optimum Currency Area</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>OMT</td>
<td>Outright Monetary Transactions</td>
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<td>OPCS</td>
<td>Operations and Policy Country Services (World Bank)</td>
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<td>OPEC</td>
<td>Organization of the Petroleum Exporting Countries</td>
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<td>OPEC Fund</td>
<td>OPEC Fund for International Development</td>
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<td>OTC</td>
<td>Organisation for Trade Co-operation</td>
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<tr>
<td>Oxfam</td>
<td>Humanitarian NGO, originally ‘Oxford Committee for Famine Relief’</td>
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<td>P2P</td>
<td>Peer-to-peer</td>
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<td>P4R</td>
<td>Program for Results (World Bank)</td>
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<td>PASOK</td>
<td>Pan-Hellenic Socialist Movement (Greece)</td>
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<td>PCL</td>
<td>Precautionary credit line</td>
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<tr>
<td>PIIGS</td>
<td>Portugal, Italy, Ireland, Greece, and Spain</td>
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<tr>
<td>PIPA</td>
<td>Protect Intellectual Property Act</td>
</tr>
<tr>
<td>PTA</td>
<td>Preferential trade agreement</td>
</tr>
<tr>
<td>RDBs</td>
<td>Regional development banks</td>
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<tr>
<td>SAP</td>
<td>Structural adjustment programme</td>
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</table>
Abbreviations

SARS | Severe acute respiratory syndrome
SCM | Subsidies and Countervailing Measures
SDBs | Subregional Development Banks
SDRs | Special Drawing Rights
SDT | Special and differential treatment
SGP | Stability and Growth Pact
SOPA | Stop Online Piracy Act
SPS | Sanitary and phyto-sanitary measures
SSM | Single supervisory mechanism
SSM | Special safeguard mechanism
STC | Specific trade concern
SYRIZA | Coalition of the Radical Left (Greece)
TA | Technical assistance
TAA | Technical Assistance Administration
TAB | Technical Assistance Board
TAC | Technical Assistance Committee
TBT | Technical barriers to trade
TPR | Trade Policy Review
TPRB | Trade Policy Review Body
TPRM | Trade policy review mechanism
TRAFFIC | Trade Records Analysis of Flora and Fauna in Commerce
TRIMS | Trade Related Investment Measures
TRIPS | Agreement on Trade-Related Intellectual Property Rights
TSC | Transnational supermarket chain
UK | United Kingdom
UN | United Nations
UNDS | United Nations Development System
US/A | United States/of America
USTR | United States Trade Representative
WHO | World Health Organization
WIPO | World Intellectual Property Organization
WTO | World Trade Organization
Global economic governance
Players, power and paradigms

Manuela Moschella and Catherine Weaver

Introduction

For scholars and practitioners of global economic governance (GEG), the onset of the crisis in 2007–08 triggered deep cognitive dissonance. On the heels of beleaguered international trade talks, devastating volatility in global commodity prices and growing disenchantment with Western models of development and aid, the financial shocks that reverberated from Wall Street to the rest of the world called into question many of the conventional wisdoms regarding how and by whom the world economy should be run. Such dissent is hardly new, as evident in the growth of protest movements surrounding the global governance of trade, finance and development over the previous two decades (O’Brien et al. 2000; Broad 2002; Stiglitz 2002; Wilkinson 2006; Scholte 2011). Yet, the financial meltdown of the world’s leading economy significantly sharpened public awareness and attention to the exigencies of global economic governance reform.

In short, the global financial crisis incited serious reflection on the legitimacy, relevance and effectiveness of the core ideas, rules and structures that have governed the world economy over the past several decades. This in turn has sparked numerous efforts to rethink and in some cases reform the formal and informal institutions of global economic governance to redress failures of the past. Yet such revolutions, even at moments of clear ‘punctuated equilibrium’, do not happen overnight (Helleiner 2010; Moschella and Tsingou 2013). Complex crises, surrounded by pervasive uncertainty and risk, and riddled with vested interests and collective action problems, can reinforce continuity as well as spur change. Our task as scholars of global economic governance is to make sense of this chaos: to unpack and explain the dynamics of global economic governance so as to understand where we have been, where we are today and where we may be going.

To that end, there are at least three trends we observe in contemporary global economic governance that provoke an initial set of questions on the state of contemporary global governance. First, there is a clear proliferation of institutions across the world. This appears most prevalent in global trade, with an astonishing boom in preferential trade agreements and regional organizations (Baldwin 2011; Freund and Ornelas 2010; Ravenhill 2011; WTO 2011). It is also apparent in global finance, such as multilateralization of the Chiang-Mai Initiative (Grimes 2009; Henning 2011; Lombardi 2010) and growing influence of international standard-setting bodies (Büthe and Mattli 2011; Griffith-Jones et al. 2010). In international development, we
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have seen an increased presence of new bilateral aid donors outside the Organisation for Economic Co-operation and Development as well as influential private foundations such as the Bill and Melinda Gates Foundation (Kapur and Whittle 2010; Büthe et al. 2012). Why and how is this institutional landscape changing? How did the ex ante rules, norms and structures of global economic governance inhibit or compel this growth? Alternatively, how has the increase in the number, geographical diversity and variety of institutions affected how global trade, finance and development are governed today? How are new institutions challenging the relevance, legitimacy and effectiveness of pre-existing institutions?

On the other hand, there is also growth within extant institutions with respect to membership and tasks that merit closer inquiry. For example, there are an increasing number of member states in traditional international governmental organizations (IGOs), such as the World Trade Organization (WTO), International Monetary Fund (IMF) and World Bank, regional organizations (like the European Union—EU) and other global forums (such as the G-20—Group of Twenty Finance Ministers and Central Bank Governors). In the wake of the crisis, even a number of regulatory bodies, which have traditionally operated as exclusive clubs for the advanced economies, have expanded their membership (i.e. the Financial Stability Board (FSB) and the Basel Committee for Banking Supervision (BCBS)). Membership expansion has often been accompanied by task expansion that has taken place via either explicit principals’ delegation of power (as is the case with the FSB) or informal appropriation of new functions (as is the case with the IMF’s involvement with financial sector surveillance) (Moschella 2011). These developments raise important questions. To what extent is membership expansion a reflection of broader shifts in material or ideational power in the world that necessitate the inclusion of new actors and emerging powers, particularly the BRICS (Brazil, Russia, India, China and South Africa), into the fold (Alexandroff and Cooper 2010; Florini 2011; Grabel 2012)? Is mission expansion the natural outcome of structural changes in the global economy or does it reflect new power configurations and paradigms? In turn, how has expansion in both membership and tasks generated stress on the legitimacy and efficiency of existing decision-making rules and procedures and pressures for institutional reform (Hurrell 2006; Woods 2010)?

Furthermore, we also observe an increased variety in who holds authority and exercises influence in global economic governance. This speaks to the essential question of who are the global governors (Avant et al. 2010) and specifically the need to account for the presence and influence of non-state actors in our analyses. For example, the sustained growth and pressure of social movement protests over the last two decades has arguably led to the relative opening (if not fully inclusive attitude) of many economic institutions towards the input and oversight of civil society in global governance (Keck and Sikkink 1998; O’Brien et al. 2000; Busby 2010; Scholte 2011). Whose interests do civil society organizations represent? How has the influence of civil society shaped the rules and norms of contemporary global governance? To what extent has civil society’s demand for greater democratic accountability changed the structures and nature of decision-making and operations in international economic institutions?

Moreover, scholars have increasingly turned attention to the growing presence of private sector actors and private authority in global governance (Cutler et al. 1999; Hall and Biersteker 2002; Büthe 2004; Kahler and Lake 2003). They have sought to explain the rise of private regulation (Büthe 2010; Büthe and Matli 2011; Germain 2010; Matli and Woods 2009; Porter and McKeen-Edwards 2013) and the risks of regulatory capture or ‘self-regulation’ by the private sector (Baker 2010). Why have private sector actors gained voice and influence (Tsingou 2012)? When and where have public institutions delegated or ceded governance authority to the private sector, and why (Haufler 2001; Vogel 2008)? How is ‘global private regulation’ challenging traditional notions of authority and power in global governance (Büthe and Matli 2011)? What are
the normative and logistical implications of this in terms of the legitimacy and effectiveness of
global private governance in looking out for the public interest (Zürn 2004; Graz and Nölke 2008;
Matthi and Woods 2009)? How has the global financial crisis of 2007–08 strengthened or weakened
the role of different non-state actors in economic governance (Pagliari and Young 2013)?

While these observations and questions are by no means comprehensive in terms of capturing the
complex dynamic of global economic governance today, they do lead us to frame our approach in
this Handbook around the three Ps of governance: players, power and paradigms. This
heuristic allows us to organize our analysis around key driving questions: Who is playing a
central role in global economic governance of the defined issue areas? What are the sources of
material and social power that enable these ‘global governors’ to demand or assume positions of
governing authority, define agendas and write and enforce the rules of the game? What paradigms
do these players bring to the table (or, alternatively, how do dominant paradigms bring certain actors
to the table?) and how are the underlying principles and practices of global economic govern-
ance shaped by these ideas and beliefs about how the world economy does and should work?

More critically, we suggest a dynamic approach to the study of global economic governance
that is staked on the assumption that the three Ps are part of an unstable but mutually con-
stitutive relationship. Indeed, the contributions in this Handbook explore the patterns of con-
tinuity and change in players, powers and paradigms showing how the continuity/change in
one of the three dimensions is closely related to what happens in the others. Highlighting the
interconnections between the three Ps, we are interested in exploring how patterns of con-
tinuity/change within and between players, powers and paradigms shape global economic
governance in different areas of activity and result from or provoke the kinds of crises of
legitimacy, relevance and effectiveness that we observe in global economic governance today.
In other words, we conceive the relationship between power, players and paradigms, on the
one hand, and crises of legitimacy, relevance and effectiveness, on the other, as a two-way
street: the former can be shaped by the latter and vice versa. This means that what the most
important sources of powers are, who the key players and the dominant paradigms become,
both shape and are shaped by issues of legitimacy, relevance and effectiveness.

Of course, we acknowledge the methodological difficulties that derive from the adoption of
this dynamic approach. That is to say, we realize that the study of the mutual constitution of
players, powers and paradigms (as well as the mutual constitutions of the three Ps and legitimacy,
relevance and effectiveness) faces scholars with serious problems in disentangling cause-and-
effect relationships. For instance, if much of international political economy (IPE) scholarship
has been particularly successful in conceptualizing major trends in global economic governance
in the past few decades, this can be attributed to a significant extent to the epistemological
choice of focusing on one specific factor over the others. However, the burst of the global
financial crisis—in common with many of the crises that preceded it—has revealed how limited
our knowledge of the global economy was (Abdelal et al. 2010b). This Handbook thus takes up
the challenge of making sense of the complexity of the world economy, although this may
entail the more daunting task of tracing and explaining mutually constitutive phenomena.

The three Ps of global economic governance: Players, power
and paradigms

Defining global economic governance

If it is true that the hand that guides the markets is invisible, as Adam Smith purported, it is also
ture that the market ‘does not work by magic or, for that matter, by voodoo. It works through
institutions, procedures, rules, and customs’ (McMillan 2002, 8). We define global economic governance here to be the international rules-based framework through which economic actors (be they states, firms, institutionalized agencies, organized groups or individuals) seek to resolve collective action problems and promote cross-border co-ordination and co-operation in the provision or exchange of goods, money, services and technical expertise in defined issue areas of the world economy.

In common with other global governance areas where different types of legalized arrangements coexist (Abbott and Snidal 2000), global economic governance can be both formal and informal. Formal governance is manifested in law and international governmental institutions (e.g. IMF), forums (e.g. G-20 and Financial Stability Forum), international private boards (e.g. International Accounting Standards Board—IASB) and international non-governmental organizations (NGOs, e.g. Amnesty International, Greenpeace). Global economic governance can also refer to more informal sets of principles, norms and practices (including self-governance agreements) that comprise a general consensus among defined groups of actors about appropriate behaviour in key issues areas. The Global Compact and Extractive Industries Transparency Initiatives governing multinational corporations or several international arrangements for prudential regulation, which involve a complex, interrelated set of informal committees and decentralized networks engaged in technical collaboration (Porter 2005), are two cases in point.

From an instrumental or functional point of view, global economic governance is intended to promote efficiency and effectiveness in the world economy and to correct market failures by producing public goods, such as financial stability, which would be otherwise at risk of being underprovided. At the same time, however, as a system of governing authority, it is expected to also embody accountability and representation—although the question of whose interests need to be represented and who should be accountable to whom is itself a matter of controversy. Scholars are divided between those who advocate true democratic legitimacy, making global economic governance mechanisms answerable to individuals and national legislatures, and those who support more limited solutions such as enhancing transparency and expanding participation as remedial actions (c.f. Archibugi and Held 1995; Collins-Williams and Wolfe 2010; Mügge et al. 2010; Scholte 2011). Setting aside the question of what the most appropriate instruments to ensure adequate representation and accountability in global economic governance are, it is also worth noting that there is quite often tension between the above-mentioned goal of efficiency/effectiveness and the quest for legitimacy (Higgott 2012). In other words, it is not unlikely that representation and accountability mechanisms need to be subordinated for efficient and effective action to materialize. Think, for instance, of the IMF crisis management role. It would be very difficult for the Fund to effectively quell a crisis should it seek the approval of its quasi-universal membership before being allowed to intervene. In other words, the political timing does not always coincide with the market timing, making it all the more difficult to reconcile the two goals that global economic governance is expected to achieve.

Patterns of change in global economic governance can be traced back to different causal factors. One prominent explanation is that changes in global economic governance reflect evolving responses to new collective action or co-ordination problems that arise from the discovery of new technologies, new goods and services, and means of production and exchange. Such change is evident in the growth or adaptation (and sometimes elimination) of existing institutions or creation of new forms of governance. For example, the creation of the European Financial Stability Facility (EFSF) and of the European Stabilization Mechanisms (ESM) over the past few years can be interpreted as a response to the new problem of financial instability in the eurozone—a problem that was not even conceived when the European Monetary Union was launched in 1991. Likewise, the evolution of the IMF lending facilities can largely be explained as successive responses to new economic problems—be they development issues in
the 1970s (leading the Fund to create the Extended Fund Facility) or capital flows volatility in emerging economies in the 1990s (with the creation of the Supplemental Reserve Facility and the Contingent Credit Line), among others.

Next to adaptation to new problems, changes in global economic governance are also driven by contestation surrounding the underlying principles, rules and norms that shape formal and informal governance structures and practices. This is the potential for change that is sparked by tensions between the so-called rule-makers and rule-takers. Such contestation can result from shifts in the balance of power between actors in the world economy, from moments of crisis or prolonged periods of economic malaise when the validity of ideas and belief systems undergirding status quo rules and policies is called into question, or as inequities and injustices in extant rules-based frameworks are challenged. As the chapters in this Handbook show, the result of such contestation may be continuity, deeper change, or something in between. Vested interests, asymmetric bargaining power, institutional lock-in and inertia, sunk costs and pervasive uncertainty and risk all affect prospects for governance change.

Before digging into the web of factors causing change in global economic governance, for analytical purposes we analyse these factors separately. In particular, in what follows, we examine the key features of the players, power and paradigms whose interaction shape and reshape global economic governance over time.

**Players in global economic governance**

Who are the key actors and institutions that exercise power and influence over the rule-based frameworks in global economic governance? The answer given to this question reflects some of the most well-known theoretical divides in the IPE literature. Explanations can be arranged according to whether they identify the main actors as operating at the domestic, interstate or international and transnational level.

For those emphasizing the domestic roots of global economic governance, the key players are well organized interest groups that lobby domestic governments, influencing their stance in international negotiations. This explanation is well established in the trade literature, where the interests of business and farmers’ groups figure prominently in the analysis (Desler and Odell 1987; Dür 2008; Evans, Jacobson and Putnam 1993; Grossman and Helpman 2002; Woll 2008) and appeared to have shaped international agricultural negotiations that took place at the WTO between 1999 and 2006 (da Conceição-Heldt 2011). These insights are echoed in the academic scholarship on finance, where financial industry groups and associations are often identified as one of the primary players in the financial regulatory arena, capable of steering domestic and international financial governance away from measures that could undermine their interests (Underhill 1995; Wood 2005). For instance, it has been noted that the use of capital controls in a number of emerging market nations in the aftermath of the recent crisis has been supported by some important domestic interest groups whose economic interests were threatened by the exchange rate appreciation that followed financial deleveraging in advanced economies (Gallagher 2012).

Next to domestic firms and interests groups, scholars privileging a domestic perspective also shed light on the role played by sub-units of governments and other societal interests (Seabrooke 2006; Singer 2007). For instance, some of the most important global financial rules and arrangements in the banking, securities and insurance sector have been associated with the behaviour of domestic financial regulators based on their preferences on the trade-off between stability and competitiveness (Singer 2007). A further example of domestic players relevant for governance dynamics comes from the European context, where most of the Union economic
and governance arrangements have been driven by the activity of European Union bureaucrats, most of them working for the European Commission (Jabko 2006; Posner 2005).

For scholars who explain global economic governance as the outcome of interstate interactions and negotiations, the natural players are states. Scholars working in this tradition have devoted particular attention to the preferences and the behaviour of leading states. Eric Helleiner’s (1994) and Ethan Kapstein’s (1994) works on the evolution of the global financial system well exemplify these themes, by showing how the framework for governing global financial markets could not have developed without the political underpinning provided by leading states such as the USA and the UK.

Although primary attention has been devoted to the activity of leading states, the role of peripheral or small states has not gone unnoticed. For instance, Jason Sharman (2006) provides a careful examination of the way in which three dozen small tax haven jurisdictions defeated a large-state coalition in the OECD in establishing the rules that define international tax cooperation. By exploiting the costs associated with reputation damage, the small states engaged in a rhetorical battle that forced the organization and its largest members to retreat from establishing global tax standards that would have ruled out the use of tax concessions to attract foreign investment. In a similar vein, Andrew Walter (2008) has shown how the diffusion of the G-7-supported global financial governance—i.e. the one based on international financial standards developed in the aftermath of the Asian crisis in 1997–98 and modelled after Western practices in banking and securities supervision, and corporate governance—has been hindered by domestic implementation in a number of peripheral countries in the Asian region.

Examining the role of state players other than the leading ones is also of particular importance following the global financial crisis. Indeed, one of the effects of the crisis has been a power reshuffle in favour of emerging markets, as attested, among others, by the distribution of global public debt between developed and emerging market countries (Prasad and Ding 2011). Based on this power shift, it is perfectly plausible that some of these countries, such as China, will become more assertive in influencing international governance debates and outcomes. The recognition of the increasing importance of emerging markets to the governance of the global economy is also manifested in a number of reforms to the international financial architecture that have expanded the membership of key international bodies (i.e. the FSB, the BCBS and the Committee on the Global Financial System) and increased the weight of emerging and developing countries in the policy-making processes. For instance, in December 2010 the International Monetary Fund endorsed a significant realignment of its quota shares resulting in the presence of the four largest emerging economies (Brazil, China, India and Russia) among its 10 largest shareholders. A similar shift occurred shortly after at the World Bank, including a greater share of votes provided to China and the creation of a new constituency seat for Africa.

Finally, next to the players that operate mainly at the domestic and interstate level, the IPE scholarship has also devoted explicit attention to those players whose primary operating environment can be found at the international and transnational level. International organizations are the first and obvious examples here. Indeed, an important strand in international organization (IO) scholarship is the one that seeks to explain how these players autonomously and powerfully shape the content and rules that inform global economic governance at specific points in time. Here, organizations such as the WTO or the international financial institutions are the ones that have received the most attention, particularly because of their quasi-universal membership that make them particularly well placed to influence global governance dynamics (Barnett and Finnemore 2004; Abdelal 2007; Weaver 2008; Avant et al. 2010; Park and Vetterlein 2010; Chwieroth 2010).
International organizations do not exhaust the list of players whose activity has important consequences for GEG. Indeed, in line with one of the key developments of global governance in the past decades, global economic governance appears to be increasingly shaped by the activity of a complex global web of policy networks (Slaughter 2004). These networks have different composition according to the issue area in which they are involved; thus, members may include trade specialists, financial regulators or government officials. In spite of different composition, networks in GEG share a number of important characteristics: they are usually expert bodies that operate on a transgovernmental or transnational level that, in turn, favours the formation of common mindsets and preserves their isolation from political pressures. These arguments have been most forcefully explored in a number of works in global financial governance. Specifically, it has been noted that governance arrangements are highly influenced by small groupings of experts that develop common beliefs and shared understandings via processes of deliberation and information exchange (Baker 2006; McNamara 1998; Tsingou 2009). This commonality may also derive from patterns of recruitment and common professional and educational backgrounds (Chwieroth 2008).

At the transnational level, both profit and non-profit private actors are also important players. Financial industry groups and associations well represent the first group of actors. Indeed, several studies indicate how their influence on global financial governance is exerted directly on international regulatory bodies, that is, by bypassing national governments. This circumstance has led several observers to identify the phenomenon of ‘transnational regulatory capture’—although there is evidence that their influence on global financial governance has been exaggerated in some cases (Young 2012). Private actors may also influence the workings of international organizations by shifting the focus of their activities. For instance, private financial intermediaries appear able to influence the conditions included in IMF programmes because their financing is necessary for the success of Fund-designed programmes (Gould 2003). Non-profit private groups, such as transnational advocacy groups, may also exert similar influence when their claims are supported by key state players (Broome 2009) or by sympathetic staff members within international organizations (Park 2005; Woods 2006; Weaver 2008; Park and Vetterlein 2010).

As this brief overview of some of the major themes in the IPE literature reveals, global economic governance is a very crowded arena including players as diverse as states, intergovernmental organizations, expert bodies and private actors. To complicate the landscape, these players tend to intermingle. They do not solely move from one policy realm to another, as is the case, for instance, with the IMF’s involvement in financial stability as well as development issues. They also switch from the private to the public sector and vice versa through the phenomenon of ‘revolving doors’ (Seabrooke and Tsingou 2009), making the task of identifying the key players difficult and time-sensitive. Indeed, players, their influence and their policy position change significantly over time, thus inviting investigation of the causes of such change.

Changes in material and social power and paradigms, as discussed in the following sections, are certainly key in this respect. Indeed, identifying the key players in GEG is strictly dependent upon the sources of power that the players command and upon dominant understandings about how the global economy should work. Nevertheless, it would be a mistake to focus on one factor over the others as the ultimate cause of change. Players are not solely constituted by changes in power and paradigms, but they themselves constitute those same sources of power and reinforce or weaken economic paradigms.

Power and global economic governance

As in any form of government, the working of global economic governance is dependent on the exercise of power in order to generate the ‘system of rules’ that guide the behaviour of
economic actors and stabilize their expectations (Rosenau 1992, 4). The production of rules, however, is just one of the many forms through which power is exercised (for a representative argument of this point see Bachrach and Baratz 1962; also Barnett and Duvall 2005). Limiting our analysis to the case of global economic governance, and with no claim of being exhaustive, there are several ways in which power manifests itself. For instance, power does not solely entail deciding the rules by which other actors play, but it also refers to the capacity of setting political agendas and taking actions to enforce the rules of the game. These actions can be used to punish, coerce or shame actors engaging in deviant behaviour. The international financial institutions (IFIs), bond markets and credit rating agencies all seem to exercise this form of power in global economic governance (Hardie 2011; Sinclair 2005).

The nature of power can also be defined in terms of controlling access to the resources that other actors crave or need. This form of power is well exemplified in the ‘international organization of credit’, where power is a function of who controls the access to credit, who is privileged by access to credit and who reaps the advantage that access to credit implies (Germain 1997; Strange 1988). Furthermore, another form of power is the one that is manifested by gaining control over the economic destiny of other players, as is the case, for instance, when a bloc of countries adopt the currency of a country outside the bloc as a peg or as the means of international transactions (Kirshner 1995). In short, the nature of power is far from uniform, and more than one form of power may be exercised at the same time.

Power also stems from very different sources, and scholars have tended to emphasize one over others according to their theoretical alignment. In general, sources of power can be distinguished based on their hard or soft nature: the former refers to material resources, whereas the second stresses the consequences of shared understandings. Those accounts that choose not to emphasize either of these factors take as their starting point the role played by formal institutions in shaping power relationships. In what follows, we analyse each of these sources of power in turn. Before doing that, however, it is worth noting that, while some of the sources of power analysed below solely apply to states, these have the potential to empower both state and non-state actors.

For scholars adopting the first perspective, market size figures prominently in the list of material conditions from which power in global economic governance stems (Drezner 2007; Gilpin 1981, 1987). This factor plays, of course, into the hands of the biggest states in the economic system. Indeed, market size endows great powers with the option of economic coercion as a way of convincing other actors to change their economic rules and institutions in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers. A corollary of this line of thinking is that leading states have an advantage in setting international rules because they set the economic practices in line with those preferred by the great powers.
between creditors and debtors and their search for wealth (Palan et al. 2010). Over time, there
have been crises—i.e. the 1930s, the 1970s and the present crisis—after which a new economic
order came into place; and new order tended to be set by the creditor nation (Coggan 2012).

A rival interpretation of power in global economic governance is provided by scholars who
stress its social or normative foundations. Social power can be defined as ‘the ability to set
standards, create norms and values that are deemed legitimate and desirable, without resorting to
coercion or payment’ (van Ham 2010). This definition captures two important features of
power: its non-coercive sources and its claims to legitimacy. To start with, the sources of power
are conceived primarily as related to the realm of persuasion that stems from the ability to define
meanings and constitute reality. Barnett and Finnemore (2004, 6) have provided one of
the most convincing examples of these sources of power in their study of IOs by showing that
these players ‘are powerful not so much because they possess material and informational
resources but, more fundamentally, because they use their authority to orient action and create
social reality’. Technical knowledge and processes of socialization are important supporting
factors in this respect. Indeed, technical, expert co-operation tends to foster cognitive con-
vergence and shared understandings that, in turn, shape the goals and instruments of economic
governance, from monetary co-operation to regulatory intervention (e.g. McNamara 1998;
Porter 2005; Abdelal, Blyth and Parsons 2010a).

One core concept associated with the social foundations of power is legitimacy. In particular,
this concept reminds us that those who govern are compelled to make claims to the rightfulness
and fairness of their actions, and that those who are governed have some capacity to reject or
approve these claims (Seabrooke 2006). As a result, legitimacy is more than a property that
global economic governance can acquire through institutional reforms, such as decision-making
and governance reforms. Rather, legitimacy is an inter-subjective belief about how and why to
govern the world economy and it is thereby dependent on a collective audience to be sustained
over time (Moschella 2009). Thus, understanding this dynamic relationship between rulers and
ruled permits us to develop a deeper understanding of the stability (or instability) of global
economic governance in different periods of time.

Finally, another explanation of power in global economic governance focuses on its institu-
tional determinants. Studies in this tradition include those adopting a principal–agent (PA)
approach to the study of IOs. From this perspective, the power of an international agent is
strictly dependent upon the terms of delegation, including both the scope of the mandate and
the control mechanisms set up to minimize episodes of agency slack (Hawkins et al. 2006). This
sensitivity to institutional factors is embraced by scholars whose work explores decision-making
procedures and the channels for veto players in international economic institutions. These
institutional factors may help explain, for instance, the continuing power of the EU within the
IMF in spite of its decreased economic weight in the world economy as compared to most
depending market countries (Bini-Smaghi 2004). In a similar vein, the procedures that the Basel
Committee employs to consult the banking sector when drafting its regulatory standards are
considered an important source of power for the private actors that gain access to the decision-
making process (Young 2012). The location that players occupy in the international policy
network also adds to the list of institutional factors that increase the influence of certain players
over the others (Baker 2012).

Taking an historical institutionalist approach, some authors (Bach and Newman 2007; Fioretos
2010) have also noted that the sources of power at the global stage lie in domestic regulatory
institutions. A key concept used by this literature is ‘regulatory capacity’, defined as ‘a jurisdic-
tion’s ability to formulate, monitor, and enforce a set of market rules’ (Bach and Newman
2007, 831). Political centralization in domestic jurisdiction may also increase the power that
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may be used in international contexts shaping GEG rules and practices (Posner 2009). Domestic firms may also influence global governance arrangements based on their organization within the nation-state. For instance, it has been found that firms operating in a hierarchical and co-ordinated domestic system are well positioned to influence the outcome of global standardization processes because their system fits more naturally with the global structure, where a single regulator is the clear focal point (Büthe and Mattli 2011).

These observations on the nature and sources of power lead us to emphasize a number of points that will also emerge from the case-studies that follow. To start with, social and material power is not confined to states or the public sector in general, as embodied, for instance, in the workings of intergovernmental organizations. Instead, power may well be exercised by a variety of players ranging from groups of regulators who usually operate out of the limelight of public scrutiny to private sector actors. Furthermore, the sources of power are hardly constant, but rather subject to evolution because of changes in underlying market or normative conditions. For instance, the rise of the BRICS’ markets, whose economic potential is often invoked to sustain global demand in the aftermath of the global financial crisis, challenges existing power relationships based on market size dynamics. Likewise, the ongoing reforms to the Fund’s governance structure, although still limited in scope, could trigger consequences for the repartition of power in GEG that are not easily anticipated or deliberately designed at this stage. Changes in power can also be brought about by changes in legitimacy perceptions which may, in turn, be related to changes in market shares and institutionalized procedures. Legitimacy crises may also be ignited by policy failures and technical inefficiency that catalyze public attention. These are precisely the conditions of the post-crisis environment, which has been characterized by an unusual politicization of the debate around financial regulatory issues (Helleiner et al. 2009; Moschella and Tsingou 2012; Véròn 2012; Pagliari and Young 2013). These changes in the policy-making context have set the stage for the contestation of the ‘quiet power’ that public and private sector regulators have long exercised in global financial governance and that had largely gone unnoticed before the crisis burst.

Paradigms in global economic governance

Finally, the activity of players and the sources of power in GEG are reinforced or weakened by the existence of policy paradigms. Specifically, paradigms can be defined as a ‘system of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing’ (Hall 1993, 279). Thus, paradigms do not simply regulate behaviour. They also serve as interpretative and constitutive devices in that they shape how people understand political-economic problems, define their goals and strategies, and settle on specific policy solutions (Blyth 2002; Abdelal et al. 2010a). Although paradigms could be treated as a source of power for those players who support their adoption, they also often independently shape global economic governance. Indeed, once a paradigm becomes instantiated into the rules and institutions that govern a specific area of economic activity, its effects may no longer be dependent on the interests of the players that contributed to their emergence and acceptance. Rather, a paradigm ‘is influential precisely because so much of it is taken for granted and unnamable to scrutiny as a whole’ (Hall 1993, 279).

Paradigms thus constitute a potent source of stability (or, alternatively, inertia). Once a paradigm becomes crystallized in formal institutions and informal practices, it stabilizes players’ expectations about how the world economy works and legitimizes the goals set by specific players and the instruments they adopt for solving economic problems. In doing so, paradigms
Players, power and paradigms

reinforce structures of power in that those who set the rules gained their authority from the perceived credibility of dominant ideational frameworks. Like institutions, paradigms can be sticky due to vested interests or habitus. In short, there are positive feedback loops between paradigms, players and power.

The feedback loop, however, is not necessarily self-reinforcing. It may well break down, triggering important consequences for GEG. For instance, the positive, self-reinforcing loop between players, power and paradigms can be interrupted because the latter are called into question by changes at the level of both players and source of power. For instance, the rise of new economic powers can challenge dominant understandings about how the economy should work and be organized, especially when this rise is accompanied by the economic decline of previously dominant players. These are precisely the conditions in the post-crisis environment.

With most of these economies mired in recession and hostage to bond markets, one of the lessons that can be insinuated from the global financial crisis is that the West may not have much to teach the rest of the world when it comes to organizing a sound financial system. The impact of the financial crisis on the real economy has also called into question the fundamental legitimacy and effectiveness of Western development models that looked down upon state intervention in the market as a means of fostering strong and stable macroeconomic growth and innovation (Mahatir 2012). In this context, ‘key Asian governments, especially China and India, are increasingly disinclined to be willing to continue as rule-takers rather than rule-makers in the international system’—although it is still far from clear what rules they are likely to want to make, thus casting doubt on whether or in what ways a power shift in Asia would change the nature of world order (Florini 2011, 25).

Paradigm change can also be triggered by changes in the sources of power such as repeated policy failures that undermine the technical base that informs much of contemporary global economic governance (Porter 2003). Changes in institutional sources of power, such as the quota and voice reforms at the IMF, World Bank, FSF and G-20, may also trigger paradigm change by opening debate to alternative ways of thinking about the organization of the global economy. For instance, new institutional channels can provide new sovereign and private aid donors with the means to challenge conventional philosophies and operational modes of providing development assistance (Findley in this Handbook; Büthe in this Handbook). This pattern is already evident in the development assistance provided by China (now arguably one of the largest bilateral aid donors in the world), which explicitly challenges traditional definitions of Western aid by blending investment and aid and intentionally invoking the rhetoric of ‘partnerships’ as opposed to external assistance (Brautigam 2009; Woods 2008; Grabel 2012).

Another channel of paradigm change can be found in authority contests during which several players fight each other to establish their vision about how the world works (Blyth 2012). Discontent is usually a powerful trigger here: rising unemployment, falling living standards and stagnant output or recession may combine to exhaust the credibility of the rule-makers and tempt their opponents to attack the very foundations of existing economic organization. Occupy Wall Street, the Spanish indignados and the other grassroots movements that spread throughout 2011 are perhaps the most obvious recent examples. Indeed, these groups have attacked some of the core tenets of dominant economic models, rejecting austerity as a route to economic recovery and calling for genuinely transparent and effective regulation of the financial system. In doing so, they have attacked the perceived authority and legitimacy of private and public sector actors still clinging to the notion that markets worked best free of government regulation and they have pushed for new institutions and rules to govern global finance in ways that shift power and authority from the ‘1%’ to the democratically represented ‘99%’. 
The discussion thus far is not meant to suggest that paradigms are easy to change. To the contrary, as Keynes has long noted, ‘the difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds’ (Keynes 1936, viii). In short, it is very difficult to dismantle old systems of ideas. Several factors usually hinder the process of change. These include among others the concentration of power in a limited number of players, vested interests in dominant institutional positions, gaps in implementation capacity, bureaucratic inertia and the fragmentation of the decision-making context (Moschella and Tsingou 2013; Robert Wade 1996; Broad 2006; Güven 2012). Hence, it is not a foregone conclusion that paradigms will change, even when their core ideas and resulting policies are widely discredited.

The global financial crisis initiated in 2007–08 has offered one of the most vivid examples of the importance of stability/change of paradigms to global economic governance dynamics. Indeed, before the crisis erupted, global financial governance was strongly rooted in the tenets of orthodox economics and the belief that the unbridled pursuit of rational self-interest and profit, disciplined by the self-regulating market economy, would yield systemic long-term stability and growth (Baker 2012). This unquestioned adherence to the efficient market hypotheses was part of what can be regarded as a policy paradigm, embraced during the era of the ‘Great Moderation’ from the mid-1980s up to the eve of the financial crash in 2007 (Quiggin 2010). The inherent prescription embedded in this paradigm was that public authorities should adopt a ‘hands-off’ regulatory style, letting market discipline exercise its stabilizing force and letting private actors decide when and how to self-regulate (Germain 2010; Helleiner et al. 2009; Moschella 2010). Within this interpretative framework, it was possible to believe that ‘prices generated by financial markets represent the best estimate of the value of any investment’ (Quiggin 2010, 2), thus lending support to the view that the private sector ‘knows best’ (Kodres and Narain 2010, 4). In other words, a specific world view of financial markets, emphasizing their self-stabilizing quality in virtue of their rational efficiency and capacity to process and respond to information, coloured the governance of global finance in the period that preceded the global financial crisis (Best 2010; Blyth 2003).

This set of ideas had important policy implications. As anticipated, its embrace meant the adoption of a hands-off regulatory and supervisory approach over the activities of market actors, with the attendant build-up of leverage and financial risks in the private sector. Furthermore, this approach favoured the phenomenon known as ‘intellectual capture’, that is to say, the then-dominant regulatory approach that blinded policy-makers and regulators to the emerging risks and even led them to rule out the possibility that a major financial crisis in large advanced economies was likely (IEO 2011). In short, the pre-crisis dominant paradigm is certainly among the contributing causes that led to the crisis—a failure that has opened the door to a profound rethink in several areas.

Indeed, as the world economy has succumbed to stress, so also have many of the old pre-crisis certainties. For example, the crisis has shaken the belief that central banks should focus on price stability and ignore the build-up of credit bubbles; that the main sources of financial instability lie in emerging market economies; that these same economies can be decoupled from what goes on in the advanced world; that market discipline, transparency and microprudential regulation are sufficient policy tools to ensure financial stability; that a monetary union can exist without fiscal co-ordination; and that the IMF’s primary role should be that of monitoring over the Chinese exchange rate policy. The crisis also opened to re-examination the principles that had guided mainstream development economics over the past decades, from the role of governments in the markets to the strategies for poverty reduction and business competitiveness (Canuto and Giugale 2010).
Does this mean that we are witnessing a paradigm change? It is probably too soon to tell. Nevertheless, the ongoing contestation has the potential to reshape the contours of global economic governance. However, the ultimate outcome of this battle will be decided by the unstable, dynamic relationship that links together players, power and paradigms.

Plan of the book

The purpose of this Handbook is to provide accessible and timely analyses of shifts in players, power and paradigms within distinct issue areas and institutional arenas of global economic governance. That is, we take a holistic approach to the study of global economic governance that aims to bring to the surface the spill-over effects within and between the three Ps. The Handbook thus seeks to advance our understanding of the interconnectedness that stands at the core of the architecture of global economic governance.

We have organized the book around three major pillars of global economic activity: trade, finance and money, and development. Each of these three sections is introduced by a contribution that examines the main features of governance in the specific area of economic activity. Particular attention is devoted to the historical trajectory through which the governance of trade, finance and development has been shaped over time. Rorden Wilkinson’s chapter (Chapter 2), for instance, sheds light on the institutional evolution that led to the WTO creation. In doing so, he challenges the conventional view according to which the global trade regime is the result of tenacious international efforts to pursue peace through the build-up of solid and mutually beneficial trade relationships. Rather, Wilkinson submits, the global trade regime reflects a particular set of global power relations and its institutional design was mainly developed to pursue the national interests of its founding and most dominant members. In introducing the finance and money section, Randall Germain (Chapter 7) explores the evolution of global financial governance by shedding light on the relationship between private institutions and state agencies, and between domestic and international levels of authority. His analysis reveals that the roots of today’s financial governance can be traced back to the late 19th century. Germain also emphasizes that the evolution of global financial governance is closely related to the evolution of financial institutions and their activities, together with the development of relations among state-led regulatory institutions such as central banks. Furthermore, over the 20th century, global financial governance has progressively encompassed an international element made up of the relations among central banks and other regulatory agencies, along with the creation of specialized international financial institutions. As for the evolution of the global development regime, David Williams illustrates and explains the main changes that have taken place in the provision of aid to developing countries (Chapter 16). Specifically, Williams draws attention to the roots of the international development regime by shedding light on the role played by the United States since the end of the Second World War and the transformation of the developmental paradigm. Aid was indeed seen as an important instrument in the foreign relations of the United States in the context of its broader ambition to create a relatively open and prosperous international economy and in the context of Cold War competition. These motivations animated not only the US foreign aid activity but they also provided a key driver for the institutionalization of the provision of development aid with the creation of bilateral and multilateral agencies.

These three chapters capture well some of the specificities of governance in trade, finance and development, respectively. In spite of these specificities, however, these introductory chapters share a number of important insights that are crucial to the understanding of the evolution of global economic governance at large. Indeed, each of the three chapters points to the
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increasing plurality of players that are involved in governance decisions. And, even when states still play a predominant role, as is the case in Wilkinson’s and Williams’s chapters for instance, the proliferation of competing actors including international institutions, NGOs and private actors is a phenomenon that is difficult to ignore. Power asymmetries are another element that all authors emphasize in their chapters. They can be conceived as ‘asymmetries of opportunities’ (gains are not equal for all participants, as Wilkinson suggests) or as an uneven distribution of power resources (as is the case in Germain’s account). Another cross-cutting theme regards the path-dependent evolution of global economic governance in that previous institutional developments always affect later ones. For instance, discussing the 19th-century global financial governance, based around *haute finance*, Germain notes that ‘while there is scholarly debate about the efficacy of this essentially private form of governance, there can be no doubt that it formed the essential bedrock upon which later attempts to extend and entrench global governance were built’. The transformations of paradigms and crisis narratives are key to the developments in global economic governance. Crisis and change are indeed intertwined in the evolution of global economic governance. And a crisis narrative can even be considered as a necessary condition to create ‘momentum’ behind the evolution of global governance (Wilkinson in this volume).

The general trends in GEG identified by Wilkinson, Germain and Williams are then further expanded and specified in the single empirical chapters that make up this Handbook. Each chapter is indeed designed to provide an overview of the major principles, rules, norms and formal and informal institutions that have governed international economic activity within the issue areas of trade, finance and money, and development. In their examination, the contributing authors tackle the driving questions regarding patterns of continuity and change in the key players, power and paradigms and how they are related to crises of legitimacy, relevance and effectiveness.

In Chapter 3, Robert Wolfe investigates an important dimension of the WTO work, namely the promotion of transparency in trade policy. Providing an overview of the way in which transparency has developed over time, the author highlights the efficiency challenges that this development entails. Indeed, transparency can be conceived as a double-edged sword: it can act as a ‘disinfectant’, but it may also undermine the privacy that is essential to negotiations and hinder the process of liberalization.

In Chapter 4, Eugenia da Conceição-Heldt examines one of the key players in the global trade regime, namely the European Union, as well as the impact of EU preferences and behaviour on the global trade regime. Focusing on the EU’s strategy to rely on regionalism and bilateralism, she highlights the risk of fragmentation in the global trade regime deriving from the erosion of the WTO principle of non-discrimination or reciprocity.

Chapter 5 is devoted to the exploration of the governance of intellectual property. Here, Susan Sell captures the key features and challenges of the governance of this important area of economic activity. These features include the proliferation of fora, forum shopping and the increasing relevance of non-state actors, from private sector rights holders to public health advocates and crusaders for internet freedom. This peculiar configuration of governance risks overlapping mandates across the institutions involved and creates disparities of access for the several players involved.

In Chapter 6, Kim Burnett and Jennifer Clapp evaluate the emergence and evolution of the governance of trade in global food and agriculture. In doing so, they bring to the surface a crucial shift in the key players, their sources of power and perspectives on agricultural trade. In particular, they highlight a shift from agricultural trade dominated by state actors to a system where private actors have taken a leading role in shaping the rules and practices that govern the system. Private actors here refer to large-scale agricultural commodity trading firms and
supermarket chains. This shift raises serious challenges to the legitimacy of the current agricultural trade regime, as attested by the movements that have emerged to resist the regime, such as the fair trade and food sovereignty movements.

Moving from trade to money and financial governance, Chapter 8 examines the origins of the G-20 summits. Specifically, Lora Viola investigates the motivations that led to the creation of this body and the institutional design and governance functions of the G-20. In doing so, she identifies the main effectiveness and legitimacy challenges that the G-20 is likely to confront. In particular, she emphasizes how the very exclusivity and informality that characterize the G-20 create problems of legitimacy and authority. At the same time, however, Viola highlights the advancements in GEG that the creation of the G-20 has achieved. First, its membership reflects a growing realization that the balance of power among the central players in the global economy has shifted and that existing institutions insufficiently reflect this shift. Second, she submits that the G-20’s institutional flexibility and its networked interaction with the international financial institutions reflect a leaner, more rapid reaction force than the cumbersome and entrenched IGOs of the post-Second World War period.

In Chapter 9, Heather McKeen-Edwards and Tony Porter shed light on the complex and variegated relationship between private and public governance. In particular, they provide a survey of private governance mechanisms in global finance, drawing attention to the governance roles played by business practices and infrastructures. These roles go beyond lobbying to include more complex collaboration with public authorities in the making of rules, the creation of sets of standards for industry, the ability to modify the conduct of firms and, through educational programmes, the creation of objects that are crucial to market interactions, such as model contracts or the coding of electronic systems. Assessing the different roles that private actors perform in global financial governance, McKeen-Edwards and Porter also find that, although the global financial crisis that began in 2007 did serious damage to the legitimacy of private governance, private governance ultimately retains a surprising degree of legitimacy.

In Chapter 10, Stefano Pagliari examines one of the newest governance bodies in global financial governance, namely the Financial Stability Board. In particular, he provides a historical overview of the FSB and examines the tasks it performs. In doing that, he shows that the role of the FSB has evolved from being primarily a co-ordination mechanism to an institution capable of exercising greater independent influence over global economic governance. Similar to what Viola argues for the G-20 leaders, Pagliari notes that the expansion in the membership of the FSB and the incorporation of the main emerging countries has not fully addressed the legitimacy problems of this body. Furthermore, it is not clear yet how the FSB will be able to reconcile the expanded membership with the consensus-based decision-making process that governs the institution.

Chapter 11 focuses on one of the longest standing institutions in global financial and monetary governance, the IMF. Here, Steve Nelson concentrates on the changing role of IMF lending, also providing interesting insights into the changes that have taken place since the start of the global financial crisis. Examining the evolution of the Fund’s financial assistance, the author draws attention to the importance of economic ideas regarding how to balance the current account and the lack of theoretical alternatives to the focus on public spending as a way to address external payment problems. And, although the record of its lending programs has been chequered at best, Nelson argues that this is not evidence of a legitimacy crisis. From his perspective, the IMF has been, and will remain, essentially the only game in town when global financial markets enter a state of turmoil.

In Chapter 12, Kevin Gallagher traces the history of governing global capital flows and presents a framework for understanding three distinct eras in the modern governance of global financial systems.
capital. His framework emphasizes how power, interests, ideas and institutions interacted (and continue interacting) to shape each era in different combinations to yield different outcomes. Gallagher also concentrates on current developments, suggesting that what has emerged since the global financial crisis is an incoherent mix of co-operative decentralization and strong international standards that may threaten the ability of nations to govern global capital effectively.

In Chapter 13, Ronen Palan and Anastasia Nesvetailova offer an examination of the major players shaping the regulatory debate on offshore and shadow banking, including the core industrialized countries and, to a lesser extent, China. Next to these state actors, however, a plurality of other non-state actors is also key to the development of regulation of this important area of economic activity. These include both private stakeholders, such as banks, hedge funds and international professional services companies, and civil society organizations, such as the Tax Justice Network or Finance Watch. Palan and Nesvetailova also note that the political confrontation among these key actors is taking place in the absence of a clearly defined paradigm of regulation and governance.

Chapter 14 is devoted to the examination of the eurozone debt crisis and its implications for GEG. In particular, Matthias Matthijs explores the main factors that contributed to the crisis. These include the diverging interests among the various players (including the European Monetary Union (EMU) member states, the IMF, and the main EU institutions), the relative effectiveness or power of Europe’s supra-national institutions and the battle of economic paradigms at the heart of the crisis in trying to determine how the eurozone should be governed in the future. After looking at the medium-term prospects of Europe’s single currency, the chapter also engages with the implications of the euro crisis for the global governance of finance and money in today’s world economy.

In Chapter 15 Mihn Ly reflects on the dollar’s status as the leading international reserve currency. In particular, he engages with the question of what the future holds for the dollar as compared to alternative reserve currencies. Adopting an institutionalist approach, which complements market, instrumental and geopolitical perspectives on reserve currency status, the author suggests that neither the IMF nor the European Central Bank (ECB) currently has the institutional powers that the U.S. Federal Reserve has to support special drawing rights (SDRs) or the euro to sufficiently challenge the dollar.

The last substantive section of the Handbook is dedicated to development. In Chapter 17, Matthew Winters and Shyam Kulkarni focus on the World Bank and its role as a lender of international development funds. Focusing on the ‘governance and anticorruption’ agenda, they show how this agenda emerged as the product of crises of legitimacy and effectiveness linked to the failures of structural adjustment lending during the 1980s and early 1990s. They also highlight the continued weaknesses of the governance and anti-corruption (GAC) agenda. In their view, these weaknesses derive from the challenges of creating better governing institutions in the developing world; the disbursement culture that drives bureaucratic decisions within the Bank; and the unanswered question of to which constituencies the Bank should be responsive.

In Chapter 18 Stephen Browne reviews the challenges facing the UN development system (UNDS). In particular, he draws attention to the increasing fragmentation of the system (which, in turn, is closely related to its historical evolution), duplication of effort and unhealthy competition. Browne also notes that the system remains heavily dependent on traditional developed country donors and their contributions. In spite of these shortcomings, the author suggests that change is unlikely to come soon, if at all. He argues that there is little motivation either from within or from outside to reform a system that, while not very effective in terms of development support, enjoys a comfortable relationship with the member states.
Chapter 19 is dedicated to the examination of regional development banks (RDBs) in global economic governance. Here, Jonathan Strand describes both the historical contexts of the major RDBs and their internal governance. The author devotes particular attention to the investigation of the role that bureaucracies and ideational aspects play in the RDBs’ lending practices. Strand also sheds light on the response of the RDBs to the 2007–08 financial crisis, arguing that the RDBs’ crisis reaction reflects the close ties between these banks and other leading development institutions and ideas.

In Chapter 20, Michael Findley and Katherine Kitterman expand the research agenda of development by devoting attention to new players in the provision of aid. In particular, they focus on the non-DAC donors—that is to say, donors that do not belong to the OECD’s Development Assistance Committee (DAC). Considering differences between DAC and non-DAC donors over time (1973–2009), by region of recipient, and by aid sector, the authors highlight how non-DAC donors have grown in influence and have begun to pose a potential challenge to the traditional DAC approach. Indeed, these new donors offer alternative development models and may introduce competitive pressures into the aid market.

In Chapter 21, Tim Büthe and Cindy Cheng examine the role of private actors in raising, allocating and implementing international development aid. With particular attention paid to transnational aid NGOs, the authors examine the sources of their power and influence and examine how ideas about development and aid have shaped the rise of these new players. In doing so, they identify the main challenges that the activities of these players entail. In particular, they identify serious accountability challenges in that donors’ and local beneficiaries’ ability to hold service providers accountable.

Collectively, these chapters indicate that we are living an era of changes and tensions within the existing structures of global economic governance. First, the range of players involved in governance decisions has continued to increase over time, including both states and a huge variety of non-state actors. And, even among states, the identity of relevant players is changing with the progressive rise of emerging market countries. Second, the sources of power have expanded to include both material and institutional resources, such as channels of access to decision-making processes. The fragmentation of governance in several areas of economic activity analysed here also reveals that some players are more powerful than others because they are able to exploit such institutional fragmentation. Finally, economic paradigms are evolving, but, interestingly, the pace and direction of their change is limited and constrained by the legacies of past ideas as well as by the governance mechanisms that are in place. As a result, rather than dramatic changes in how the global economy is governed, a common pattern that seems to be emerging from the case studies is a process of progressive adaptation and adjustments at the margins. It is also interesting to note that the case studies indicate that today’s GEG is torn between opposing trends. For instance, if on the one hand the global financial crisis of 2007–08 has reaffirmed the importance of IMF lending, on the other hand, this process is undermined by the concomitant rise of financial regionalism both in Asia and Europe. Likewise, there is a growing tension between the regime on capital controls embodied by the IMF (which allows for the use of controls at least in principle) and the regime on controls under regional or bilateral investment treaties (that rule out the use of controls).

In order to make sense of all these emerging trends, the last chapter of this volume takes up a systemic perspective by examining the shifts in power, players and paradigms since 2008 in an effort to develop expectations for the future of global economic governance. Here Daniel Drezner identifies competing forces at play. On the one hand, he notes that the number of actors possessing ‘deterrent power’ has increased. This increases uncertainty about power and preferences, making policy co-ordination unquestionably harder. On the other hand, there is an
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incredible resilience in the paradigm that animates the international economic order. As Drezner notes, ‘At both the elite and mass levels, the demand for substantive alterations to the neoclassical economic paradigm has been relatively muted’. As a result, since the start of the crisis, no alternative policy paradigm has emerged, and the policy changes adopted thus far have been minor tinkering to the governance of the global economic order and have even reinforced the status quo. Drezner thus submits that, although the sources of disagreement have increased, paralleling the rise of new players, disagreements about the social purpose of the global economic order have not.

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Players, power and paradigms


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Part I

Governing global trade
2

Plus ça change?

Business as usual in the governance of global trade

Rorden Wilkinson

There are two stories that almost all students and practitioners learn when they encounter the World Trade Organization (WTO) for the first time. The first is a story about the institution’s origins. More often than not the story begins with the tumultuous days of the interwar depression, wherein dark images invoking Steinbeck’s Grapes of Wrath and the descent, first, into political extremism and, then, war provide the context for a discussion of beggar-thy-neighbour policies and the notorious Smoot-Hawley tariff. The story then moves onto wartime efforts to resurrect international trade and the ill-fated attempts to establish a trade institution—the International Trade Organization (ITO)—as the third grand post-war economic institution (partnering with the International Monetary Fund and the World Bank). Thereafter the story focuses on the rise of the General Agreement on Tariffs and Trade (GATT)—a limited and originally a provisional agreement—as the primary multilateral means of liberalizing trade, before discussion is made of the Uruguay round and the GATT’s metamorphosis into the WTO.

The second is a story about the pursuit of a world of prosperity through uninterrupted commerce and the vision of a truly global market. In this story the inalienable value of free trade is presented as struggling amid the turbulent politics and crises of trade rounds, bedevilled by misguided mercantilist impulses and hamstringed by successive acts of the North/South theatre in which pitched battles are fought between developed and developing countries. This story draws its intellectual sustenance from neo-classical and liberal internationalist thought and emphasizes the role that trade can play in the promotion of peace, the relationship between protectionism and the slide into war, the dangers that might result should the liberalization process be allowed to stall and the slow but necessary movement towards freer global commerce.

Variations of these two stories would be familiar to any student or practitioner of international trade at any moment since the end of the Second World War. While there may well be slight differences in the players involved (particularly those understood to be ‘rising’, with Europe, Australia, Japan, China and the remaining BRICS all having played that role at one time or another, a change of moniker for the regulating institution (ITO, GATT, OTC, WTO) and a redrawing of the fault lines of the crisis (agriculture, imperial preferences, tropical products, non-agricultural market access and services, to name a few), the core narrative would
be largely the same: of the tenacious pursuit of peace through prosperity amid the tumultuous
great power trade politics of successive GATT/WTO negotiations.

It is worth subjecting the common sense messages that these stories are designed to impart to
more than passing scrutiny. Probing beneath the surface one finds that global trade governance
is not quite what it seems, and that the pithy stories we all learn are distilled versions of more
complex tales. The common sense account of the WTO’s institutional creation and develop-
ment, for instance, tends to invoke images of an organization born out of opportunism and
happenstance, imbued—not unsurprisingly—with certain ‘birth defects’ (Jackson 1995, 600)
that have rendered it slightly less than ‘fit for purpose’. Yet, a closer examination of the histori-
tical record suggests that, rather than a slightly hapless body, we find an institution quite well
suited to the task at hand, whose performance has actually been quite strong in terms of the
objectives that it was set up to achieve and whose development has been consistently focused
on the task ahead (Wilkinson 2011; Ismail 2011). Likewise, peering beneath the simple asso-
ciation between the objective of freer trade and the activities of the WTO reveals a more
instrumental institutional role than is often assumed and a dramatic gulf between word and
deed. Moreover, it reveals that the GATT/WTO is but one of a range of institutional bodies
(including many that are regional and bilateral) set up to achieve trade gains by the leading
industrial states and which fall in and out of favour depending on the political blockages to a
particular negotiation at a given moment in time. Similarly, peeling back the cover of height-
tened political contestation reveals a form of governance in which crisis has actually acted as an
important mechanism—in terms of the pressure it has brought to bear on negotiations and the
arena of political possibility it marks out—for driving forward trade deals and a means of
encouraging forms of innovation designed to enhance the organization’s legitimacy, relevance
and effectiveness.

Far from being the slightly unfortunate institution caught in the crossfire of great power trade
politics that these common sense narratives suggest, the WTO is a more instrumental institution
that has been more effective and dynamic than is commonly understood and whose basic form
and function has changed little since its creation. Common sense narratives do of course play an
important role in the politics of global trade governance, even though—and often because—
they obscure much of what is going on (Wilkinson 2012). Equally, while there is much to the
governance of global trade that is underplayed or unappreciated, in large measure this is a tale of
institutional evolution that has enabled dramatically different trade gains—what are known in
the literature as asymmetrical outcomes (Ostry 1997)—to be accrued by participating states.
For the leading industrial states, successive trade rounds have delivered important market openings
and enabled restrictions to remain in key areas. For developing countries as a group—in as
much as generalizations like this are useful—eight rounds of negotiations have resulted in sig-
nificantly fewer economic opportunities and have actually helped accentuate, rather than
attenuate, global gaps between those that have and those that do not. Any conclusion that
results from the current Doha round will inevitably do the same (Scott and Wilkinson 2012).
Yet, our common sense understandings of the WTO paint a picture of an organization that
struggles to function, thereby obscuring the asymmetric gains that this mechanism of liberalizing
trade has produced.

My aim in this chapter is to move beyond common sense stories about global trade govern-
ance by offering an alternative account. Following Manuela Moschella and Catherine Weaver’s
lead in the introductory chapter to this volume, I concentrate on the way key players, relations of
power, ideology and discourse intersect with issues of legitimacy, relevance and effectiveness
and become enmeshed with processes of institutional resilience and adaptation. I do so in an
effort to show, in the space available, that despite much that appears to the contrary, little has
changed—or is likely to change—in the governance of global trade. In so doing, I offer an alternative account of the governance of global trade that makes sense of the periods of intransigence and heightened political contestation that so many commentators jump upon as ‘evidence’ of either the end of the institution or the coming of a new age of protectionism but which inevitably result in no change at all. And I do so in a way that offers a measure of explanation of patterns of trade politics, past, present and future.

Before I move on, a note of clarification is necessary. My own view is that too little emphasis is placed on appreciating the history of multilateral trade regulation and that rigorous historical understanding is often forsaken in our rush to consume easily digestible précis about the past. We should treat any executive summary of events gone by with great scepticism, understanding that stories about the past are always told from the viewpoint of the present and they are done so with a specific purpose in mind. Thus we need to understand, for instance, that invoking the dark days of the interwar depression to force home a point about the need for further liberalization is a discursive device designed to gain purchase in an argument, rather than an historical ‘fact’ foretelling what will come. And it is precisely because we can learn much from the lessons of the past that we ought to resist—or at least be healthily critical of—distilled accounts of events gone by, but also be mindful that, as E. H. Carr (1961, 62) noted, history is an ‘unending dialogue between the past and the present’ in which the presentation of fact is as much a political act as it is a recital of the historical record.

For the sake of clarity, the remainder of this chapter takes the same format as the two narratives that are commonly told about the multilateral trading system, albeit that I do so to get beyond distilled executive summaries. This division is of course merely for convenience of mind and where possible I knit these tales together into an organic whole. In the next section I offer an outline of the evolution of the multilateral trade institution that focuses on the political purpose for which the institution was created. I then focus on the ideological and discursive underpinnings of that story and their role in the construction of a particular subjective and normative account of how trade should be organized. In this section, I highlight the role played by crisis in the governance of global trade, and I explore how pressure for forward momentum is created within a discursive arena of what is deemed to be politically possible. In the final section I offer my concluding comments. I focus on the dangers of not thinking critically about the governance of global trade and the hazards of treating received wisdom as inalienable truth.

The birth and evolution of an institution

Global trade governance—simply understood as the complex set of formal and informal institutions (intergovernmental, regional, national and local) that combine to regulate transnational flows of goods and services—has as its centrepiece a set of rules, norms, practices and decision-making procedures in part expressed in the body of trade law overseen by the WTO and in part that have evolved through custom but which have not been formalized. This body of law knits together agreements on trade in goods, services, trade-related investment measures and trade-related intellectual property rights with a host of other smaller agreements backed up by a robust dispute settlement body that has—in international law terms—considerable enforcement power. It also requires that all other trade agreements—regional and bilateral—are WTO consistent; and it serves to lend greater coherence to global economic policymaking by bringing together the work and legal frameworks of, among others, the International Monetary Fund (IMF), World Bank and World Intellectual Property Organization (WIPO) (Wilkinson 2002; Hannah and Bernstein 2012).
The WTO is not a neutral, legal, administrative body; and presenting it in these terms robs it—and its forerunner institution, the GATT—of its essentially political character. Indeed, it is a clear understanding of this political element that is missing from many common sense accounts of global trade governance and which ensures that these narratives are often relayed as if they were ‘facts’ about trade rather than subjective accounts of how trade and the wider world ought to be organized.

The GATT/WTO—to which I refer from here on as a single institutional complex, as the latter is a grander version of the former, albeit that the General Agreement is now one of a raft of agreements administered by the WTO rather than a distinct institution in itself—is the product of a particular set of global power relations, an institutional solution to a problem perceived and a device designed to pursue the national interests of its founding and most dominant member. Moreover, its apparently neutral, legislative and administrative features are noteworthy precisely because they embed and lend legitimacy to a particular way of organizing global trade that speaks to a specific set of economic and political interests in the developed world. And it is this approach to the organization of global trade that gives rise to its character but which also helps us understand some of why trade politics is so contested.

As is recounted in most common sense stories about the multilateral trading system, the origins of the GATT/WTO lie in ill-fated wartime and post-war efforts to create an international trade organization as the third of a triumvirate of institutions designed to manage the global economy. Yet, most of these accounts merely note that the GATT/WTO grew out of the ashes of the ITO project and not the fact that the GATT was a response to blockages in the ITO negotiations. To complete the picture we need to better understand the motivations of the lead architect (the United States) in creating the institution, how these interests were expressed in the GATT’s design, and how a blockage in a multilateral forum (the ITO) led a mini-lateral gathering (the GATT) to become the primary means of global trade governance. It is to this deeper narrative that the rest of the section now turns.

Though it is often portrayed as such, the creation of a post-war trade institution was far from an ‘Allied’ project (Wilkinson 2006, 22–44). While the final shape of the post-war economic architecture was the result of a process of negotiation among the wartime Allies (in particular the USA and UK), it was US power, its special interests, its ideas and its material capabilities that provided the wherewithal. The other Allies were merely Greeks at the proverbial Roman court.

By the end of the Second World War, the USA accounted for approximately one-third of total world production and more than 50% of its output of manufactured goods. As Clair Wilcox (1949, 10–11) put it at the time, the USA was in a position to sell ‘everything to everybody’ and needed to buy ‘little of anything from anybody’. It was thus in the United States’ interests to pursue a post-war international economic policy that would enable American industry to take full advantage of these opportunities.

However, there were four notable obstacles to the USA’s trade-led industrial expansion. First, the spread of depression in the interwar years had caused many governments to implement trade-restricting and trade-diverting commercial policies in an effort to protect their national economies. Second, the persistence of trade barriers in many of the USA’s key industrial markets offered foreign producers respite in which to meet the challenge of American competition. Third, much of the colonized world was effectively closed to the USA’s commercial reach by imperial preference systems that guaranteed markets for products from the colonial powers and provided them with exclusive access to vital raw materials.

Fourth, and most significantly, the United States needed not only to ensure its goods entered foreign markets as competitively as possible, it also needed to ensure that there existed sufficient demand for its products. Some of this demand could be stimulated by prising open imperial
preference systems. But this alone would have been insufficient. The USA needed a package that would stimulate demand in its most likely market: Europe. However, in the absence of a reconstruction package, European demand for both capital and consumer goods would have been minimal and certainly not enough to help stave off post-war depression. Moreover, for US producers to take advantage of any European demand, the means by which goods were purchased had to be fully convertible into dollars. Crudely put, the solution was to provide Europe with the wherewithal to purchase American goods through a programme of loans and grants known as Marshall Aid (Hogan 1987) and to put into place a mechanism for ensuring currency convertibility—the Bretton Woods system (Van Dormael 1978).

However, American plans for reconstructing international trade had a significant caveat: agriculture. Price deflation during the 1920s and the 1930s had hit the US agricultural sector particularly hard. Tariffs, production controls, price-support schemes, import quotas and export subsidies had been put in place in response (Evans 1971, 61–63, 66–69). Moreover, the strength of the agricultural lobby in key states made any attempt to pursue liberalization by the US Government unlikely to succeed (Gardner 1956, 3, 20–21). The result was that, while the USA was willing to liberalize trade in those sectors in which it could accrue economic gain (and wherein, it should be noted, the USA faced little competition), it was not willing to do the same in areas of political and economic sensitivity. This liberal-mercantilist approach, particularly with regard to agriculture, was to become a cornerstone of the GATT.

The designs for what would have eventually become the ITO were what Robert Hudec (1990, 10) described as a résumé of ideas developed across myriad interwar and wartime gatherings. Yet, in contrast to designs for the financial and monetary aspects of the post-war economic architecture, the ITO negotiations proved particularly difficult. Although ‘approximately ninety per cent of the text of the charter’ (ITO Report 1947, 361) had been agreed ahead of the 1947 Havana Conference on Trade and Employment (which was designed to finalize and agree the ITO Charter), the outstanding 10% covered areas particularly important to the USA (such as on rules over balance of payments crises and imperial preference systems). Such were the disagreements over the content of the Charter that economic advisor to the US State Department Herbert Feis chose to comment that ‘[a]lmost every one … [was] trying to re-write important sections of the [ Charter], in the service of its special necessities, ideas, wishes or prejudices. The number of suggested amendments runs into hundreds’ (Feis 1948, 51). Clair Wilcox put the number of amendments at 800 and suggested that ‘among them as many as two hundred … would have destroyed the very foundations of the enterprise’ (Wilcox 1949, 47–49). The United States’ response was to look for a more effective means of securing its trade gains; and it did so in the form of a much more focused, lither, ‘mini-lateral’ agreement—the GATT.

The GATT was initially intended to be a stop-gap measure designed to kick-start post-war trade liberalization as well as a means of accelerating the conclusion of the ITO negotiations. The round of negotiations out of which it was created (the first round, 1947) resulted from strong pressure from a US delegation anxious to make the most of the president’s authority to negotiate tariff reductions prior to its expiry (Finlayson and Zacher 1981, 562). The result was an agreement among a small group of contracting parties to begin the process of liberalizing trade in manufactures, semi-manufactured and capital goods, but not agriculture. And, although the round was ‘successful’ in that it set post-war liberalization in motion, it was not without tension and almost collapsed—a pattern that has been repeated in every round since—over a dispute between the USA and the UK over the latter’s imperial preference system (Kock 1969, 70).

Disagreements notwithstanding, the Havana conference was eventually concluded, and 53 states signed the Final Act of the United Nations Conference on Trade and Employment which comprised the ITO Charter. The conclusion of the conference was, however, the high point
for the ITO. Of the 53 signatory states, only two sought its ratification—Australia and Liberia (ITO Report 1950, 325)—and in December 1950 Truman announced the decision to postpone indefinitely plans for US participation in the ITO, stating that the Havana Charter would not be resubmitted to Congress for approval (New York Herald Tribune, 7 December 1950). This was followed in February 1951 with similar announcements from the UK and the Netherlands (ITO Report 1951, 384–85). It was, in the end, an organization that did not serve US interests. The GATT, however, did.

It was not just the commercial focus of the GATT that was designed to reflect the interests of its lead architect (which, because of the need for US goods in war-ravaged economies, also served the short-term interests of others, particularly the European states); the legal framework of the General Agreement itself was crafted in such a way that it was congruous with American needs. The GATT was crafted around existing American commercial methods, legal frameworks, styles of negotiating and economic ideas; and the General Agreement’s extension to new contracting parties over time embedded these methods, frameworks, styles and ideas as the modus operandi for liberalization. As Herbert Feis put it,

the American government was eager to preserve in as much of the world as possible the American type of trading system; one shaped mainly to private initiative and calculation, ruled mainly by competition, nominally open to all on equal terms, unclamped by rigid controls.

(Feis 1948, 41)

The result was the construction of a commercial framework that drew from, and entrenched, practices and principles long used within the USA as well as in relations with its primary trading partners. This was manifest in, among other things, the use of the principles of most-favoured-nation (MFN), national treatment and reciprocity as cornerstones of post-war commercial regulation.

Three developments served to consolidate the GATT’s character thereafter. First, slower-than-expected European reconstruction in the immediate post-war years reinforced an almost exclusive concentration on the liberalization of industrial, manufactured and some semi-manufactured goods. Second, the de facto exclusion of agriculture from the GATT’s remit was increasingly consolidated. Third, in response to acute competition from East, South and South-East Asia, measures were put in place to formally exclude textiles and clothing from the liberalization process. In the first instance, this consisted of extracting a series of voluntary quotas limiting imports from Japan, Hong Kong, Pakistan and India and offering European and North American producers competitive respite. Thereafter these restrictions were codified, first during the Dillon Round (1960–61) with the negotiation of the Short-Term Agreement on Cotton Textiles. This, in turn, morphed into the 1962 Long-Term Agreement Regarding Trade in Cotton Textiles and subsequently the 1974 Multi-Fibre Arrangement (MFA).

Taken together these three developments resulted in the emergence of an acutely asymmetrical system of trade regulation that served the interests of the USA and its allies well. Agricultural and textile and clothing producers in the industrial states were protected from the growing competitiveness of developing and newly independent producers by the manner in which the GATT was deployed. Producers in industrial states were, nevertheless, able to benefit from negotiated reductions in barriers to trade in manufactured, semi-manufactured, low and high technology goods. But, for developing states, the combination of the constraints of their own lack of development, the absence of substantive opportunities arising from the GATT and their diminishing share of world trade, served to amplify the value of the institutional advantages afforded to the industrial states.
Some attempts were made to redress these imbalances. They were nonetheless, few and far between and lacking in substance. In 1965 the contracting parties negotiated a protocol amending the GATT (effective in 1966 and known as ‘Part IV’) in an effort to address some of the concerns of developing countries. It was, however, acutely inadequate. Part of the problem lay in Part IV’s reliance upon the goodwill of industrial states to consider adopting measures to assist developing countries in their commercial activities, rather than compelling them to put into place remedial measures. Thereafter, few attempts were forthcoming, though discussions during subsequent trade rounds on the problems facing developing countries did grow in intensity.

What is important for our purposes is that by the mid-1960s the character of multilateral trade regulation had been clearly established. At its base the GATT was a regulatory framework that had been designed to realize the opportunities afforded to the USA in the wake of the Second World War and to facilitate Western European reconstruction as a reflection thereof. Upon that base a second layer of regulation was laid. This layer accentuated the extent to which GATT liberalization concentrated on the opening of industrial and manufactured goods markets while excluding agriculture, and textiles and clothing.

The peculiar circumstances of the GATT’s birth, however, ensured that, up until this point, the development of multilateral trade regulation had been largely informal. Few hard-and-fast rules were adopted and the General Agreement (and, more properly, its principal architects) demonstrated a distinct aversion to formal institutionalization and bureaucratization. Indeed, this had previously been seen as a strength. The narrow focus of the GATT and the absence of an extensive set of highly prescriptive rules lent it a streamlined, informal and malleable quality (Gorter 1954, 7–8). It was perceived to be neither a tightly binding set of rules nor a constraint on the sovereign autonomy of the contracting parties (a feature that was particularly important to the USA). While this fluid character initially served the political and economic interests of the GATT’s most economically significant contracting parties, and was far from beneficial to its smaller, more vulnerable, developing, primary and agricultural producing counterparts, it did so only in the early years. Thereafter, pressure was increasingly brought to bear for a formalization of GATT disciplines.

The Tokyo round (1973–79) witnessed a growth in the codification of international trade rules. With this codification came an extension, consolidation and amplification of the inequalities of opportunity arising from the way in which GATT rules had been deployed. While the results of the round may have produced a more visible and extensive system of international trade law, instead of attenuating existing asymmetries, the shift away from what Sylvia Ostry (1997, 89) terms ‘broad statements of principle’ to ‘detailed legalisms’ simply made them worse.

Needless to say, the Tokyo round failed to address many of the GATT’s defects. Though progress was made on non-tariff barriers, it resulted in the negotiation of a clutch of side agreements (comprising, among others, the so-called Tokyo ‘codes’, the forerunners to the WTO’s plurilateral agreements) that were binding for (and, as a result, beneficial to) only a handful of (largely) industrial signatories. Little movement was made in liberalizing agricultural markets: the USA continued to dish out lavish export subsidies to domestic producers and impose quotas on imports of dairy produce; and European discrimination in the sector was exacerbated by the further development of its Common Agricultural Policy (CAP). Similarly, the round oversaw the continued exclusion of textiles and clothing from the GATT’s remit, first with the negotiation of the MFA and then with the extension of discrimination under MFA II. The result was the fabrication of a third layer of regulation that built upon and entrenched the asymmetry and inequity at the core of multilateral trade regulation.
It was not until the Uruguay round (1986–94) that a concerted effort to broaden the GATT’s commercial remit to include those areas of economic interest to developing countries took place. Yet, rather than attending to the asymmetries of opportunity that previous rounds of the GATT had produced, the Uruguay round actually presided over their perpetuation and amplification. The conclusion of the Uruguay round saw the inclusion of agreements on agriculture, and textiles and clothing within a wider suite of trade agreements administered by the soon-to-be-created WTO and the adoption of a range of provisions throughout the Organization’s legal framework designed to ease some of the pressure for reform generated by the new rules. It also resulted in the adoption of agreements on services (the General Agreement on Trade in Services—GATS), intellectual property (the Agreement on Trade Related Intellectual Property Rights—TRIPs) and investment measures (the Agreement on Trade Related Investment Measures—TRIMs). Yet, while the inclusion of agriculture, and textiles and clothing rectified an existing imbalance in the way in which the GATT had previously been deployed and the sprinkling of development-sensitive provisions represented a step forward from the GATT era, the introduction of new rules in services, intellectual property and investment measures simply generated additional asymmetry. Whereas, under Uruguay rules, developing states could finally hope to benefit from the liberalization of agricultural and textiles and clothing markets, their lack of capacity and resources ensured that this was not to be the case in the new areas. The potential fruits of Uruguay were much larger for the industrial states. Not only were they existing beneficiaries of trade liberalization in areas covered by GATT rules, their economic make-up ensured they would be the principal beneficiaries of the market opportunities presented by the liberalization of services and investment measures, and the codification of trade-related intellectual property rights.

What Uruguay clearly did, then, was to further divide up the arenas of economic activity in which member states could specialize and, in so doing, accentuated the problems facing developing countries seeking to diversify their export portfolios. Moreover, not only were the industrial states better suited to taking advantage of these new rules, their ability to utilize the market opportunities presented therein enabled them to develop a competitive advantage over future market entrants. The result was to carry across the transition in institutions from GATT to WTO an asymmetry of economic opportunity that would form the basis upon which future negotiations would ensue and which shapes and informs current debate in the Doha round as well as the tensions that exist among members.

The ideological and discursive underpinnings of global trade governance

No pretence was made at the outset that liberalization under the GATT would be an engine for growth for all. In contrast to its contemporary representation, the GATT was originally presented as a much more partisan instrument (Brown 1950); and it succeeded precisely because it was a narrow and specific utensil. That the GATT should be designed and presented in such an instrumental fashion is, of course, unsurprising. Its negotiation took place in the shadow of the interwar depression. The events of the 1930s had cast doubt, both within the USA and internationally, on liberalism as an intellectual project and the wisdom of maintaining an open world economy. As Jacob Viner noted at the time, ‘there are few free traders in the present-day world, and no person in authority anywhere advocates free trade’ (1947, 613). Indeed, the best that could be said of many wartime and post-war European and US policymakers was that a rough consensus existed on the need for economic planning and government intervention to correct market failure.

As such, a case had to be made for both liberalism and liberalization. The case that was made put forward a particular interpretation of history that supported both the turn back to liberalism
and the removal of those barriers to trade (particularly in markets of importance to the USA) that had been constructed in the interwar period. This case rested on the claim that, without a resurrection of multilateral trade (and the growing interconnectedness that this would foster), protectionism and insularity would flourish. If protectionism went unabated, so the story went, states would pursue their economic objectives bilaterally or regionally, which may have, in turn, led to the kind of fragmentation of the world economy that had been a feature of the 1930s.

Clair Wilcox’s account of the case for multilateral trade liberalization in the immediate post-war period captures perfectly this story (1949, 3–10, 12–13). Wilcox constructs an account of the preceding 150 years that draws selectively on the passage of world events. It warns of the consequences of not pursuing multilateral trade liberalization; it clearly associates the consequences of not pursuing liberalization with economic destitution and political extremism; it links the pursuit of liberalization with the continuation of the ‘progress’ and realization of the ‘freedoms’ of the 19th century; it makes use of disease as a metaphor to emphasize the dangers of halting and reversing the process of liberalization; it conjures up images of penury and immiseration, and liberty and prosperity to support its message; it proposes a core course of action for both the USA (as architect of, and the state with the biggest vested interest in, the post-war order) and its allies; and, most importantly, it sought to frame the first post-war round of trade negotiations in terms of building peace.

Wilcox’s account is not without its problems. The century of relative peace that Wilcox claims precedes the First World War sketches over some relatively significant conflicts such as the Napoleonic wars and the American Civil War. It also ignores a period of imperial aggrandizement and various uprisings, civil wars and rebellions that engulfed much of the world. Likewise, Wilcox’s claim that the century prior to the First World War had been one where goods moved with relative freedom is not unproblematic. British agriculture was heavily protected until the repeal of the Corn Laws (in 1846), and restrictions remained thereafter. Agricultural protectionism was a key feature of the German and Swedish economies in the late 19th century. Britain, France and Germany routinely protected their infant industries. Tariffs in the USA were consistently and uniformly high (Irwin 2001), and foreign investment in banking, shipping, mining and logging was strictly regulated (Chang 2007). And the USA, Britain, Germany and France regularly allowed copyrights and patents to be flouted (even explicitly allowing the production of counterfeit goods).

That errors exist in Wilcox’s account, and those of others like him, is not the point. The point is that the narrative had a distinct political purpose—to add weight to the case for a return to liberalism. It was compelling partly because of the logic that it presented and partly because of the way it used worries of a return to the 1930s and danger of another world war to establish its credibility. It also helped that Wilcox was a Professor of Economics at the elite Swarthmore College, temporary head of the US delegation negotiating the commercial aspects of the post-war order, and that he led the Office of International Trade Policy at the State Department from 1945–48 (the body which eventually morphed into the Office of the United States Trade Representative (USTR)).

Wilcox’s account was intended for two audiences. The first was a domestic audience opposed to a liberal internationalist US foreign policy (Diebold 1952; Zeiler 1999, 75–104). The second was US wartime allies who were preoccupied with post-war reconstruction, concerned with relations with their former and current colonies, had differing economic interests or were succumbing to growing socialist influence. Both of these audiences represented challenges to core US industrial interests and thus threatened the consolidation of US power in the wake of the war.

The case that Wilcox and others put forward quickly became received wisdom, though the usefulness of the core story did not expire with the GATT’s establishment. The highly political
nature of the GATT—the consequence of competitive negotiating among states of differing size, importance and capability, and negotiating strategies based on bluff and brinkmanship—and the manner in which the institution evolved ensured that trade negotiations were, from the very outset, highly contested affairs. The drama that ensued imbued negotiations with a propensity to crisis and, on occasion, collapse. These moments of drama were taken seriously, particularly as they threatened to undermine the institution and the purpose for which it had been designed. They also threatened to undermine the case for a return to liberalism and further liberalization. The result was that worries about what might result if liberalization should be allowed to stall continued to frame GATT negotiations, and the case was made repeatedly at moments when the institution appeared to be in crisis. What emerged was a ‘crisis discourse’—one that encouraged a particular kind of political behaviour by framing trade negotiations in a manner consistent with the conclusion of bargains by warning against what might transpire should the multilateral trade liberalization process be interrupted (Wilkinson 2009).

What is interesting about this crisis discourse is that, not only has it become a key part of the received history of the GATT, it has come to be expressed metaphorically. Metaphors had been used before—Wilcox made use of medical metaphors in making his case (1949, 12)—but one proved unique and tenacious: the bicycle. At its simplest, the bicycle metaphor suggests that trade liberalization, like the forward motion required to keep a bicycle moving, needs to be in a state of perpetual motion. If that motion were to cease, the process (like the bicycle) would collapse and cause injury to the global economy/the bicycle’s rider. The use of this metaphor served, at one and the same time, to simplify, clarify and intensify the mental image constructed by the crisis discourse of what would happen if the multilateral process were allowed to stall despite the self-evident fact that the trading system is very unlike a bicycle, nor its movement linear in the way that the metaphor would encourage us to believe. Moreover, it created an imperative around the perpetuation of a particular kind of trade liberalization—one that, as we have seen, primarily benefited the core interests underpinning the trade regime, while at the same time only offering limited prospects for those on the periphery—that has resulted in the conclusion of successive trade bargains that have been deeply asymmetrical.

It is no mistake that the bicycle metaphor emerged as serious impediments to further liberalization began to emerge in the late 1960s and early 1970s and the core story underpinning the crisis discourse no longer had the purchase it once had. By this point, GATT negotiations had become progressively harder to conclude because of increases in the number of contracting parties (which posed logistical as well as political problems, especially because of the growing militancy of newly-independent states), the growing depth and extent of the trade agenda, mounting tensions between the then European Economic Community (EEC) and the USA and growing protectionist sentiment in both, a worsening international economic environment and mounting concern among developing countries that their interests were not being served (Ibrahim 1978).

Attributed to C. Fred Bergsten, the bicycle metaphor conveyed the message of the lengthier and more involved core story to a domestic and international public and polity that was nearly 30 years removed from the end of the Second World War, nearly 40 years from the interwar depression and had enjoyed (at least in the USA) two decades of unrivalled prosperity. It did not require recipients of this received wisdom to understand the intricacies of what had caused the depression, but the necessity of maintaining forward motion sought to encourage support for further liberalization. In so doing, it made common sense of the notion that, unless the trade bicycle continually moved forward, it would topple over. As Bergsten put it, the ‘[s]teady movement toward trade liberalization is necessary to halt the acceleration of the trend toward increasing trade restrictions’ (1973, 280).
Since they were first articulated, a consensus has emerged around the logic of the crisis discourse and the bicycle metaphor. Both have become staples of trade politics and are widely known and frequently used. Moreover, in that process wherein subjective views are assimilated as social truths, the metaphor has itself been elevated to the status of both ‘theory’ and ‘fact’. As James Bacchus, founding chair of the WTO’s appellate body, puts it, “[a]ccording to the "bicycle theory," the history of trade, and of trade policymaking, teaches us that a failure to move steadily forward toward freer trade condemns the world trading system to topple over’ (2003, 429).

As the Doha round negotiations have progressed and the talks have ground to a seemingly intractable halt, subtle changes in the content of the crisis discourse have occurred. These changes are not unheard of or unprecedented. Rather, they are consistent with other moments intensification that have occurred across the life of the trade regime. One of the most striking features of recent commentary about the WTO has been the use of a dramatic and high stakes language that presents the state of the round and the plight of the Organization in life and death terms. In many cases, commentators have chosen to underline this life and death struggle with metaphors. These metaphors are often medical—such as likening the state of the round used.

In pursuing a line of argument, these metaphors are taken to their logical conclusion to reinforce the need to pursue a particular course of action. So, if the commentator is of the opinion that the Doha round is, for whatever reason, no longer of value, we are encouraged to let the patient ‘die’, engage in a spot of ‘euthanasia’ or mount an ‘assassination’ (Harbinson 2011). For those who see value in continuing the negotiations, metaphors are used to drum up support for dramatic intervention to salvage the negotiations in a manner akin to ‘surgery’, an essential ‘amputation’, or else advocate a pharmaceutical ‘cure’.

The problem with talking in such dramatic ways is that they presuppose and necessitate that quite dramatic action is necessary. In so doing, they hook readers into a form of argumentation that suggests that only a particular course of action consistent with the commentator’s predisposition is worth pursuing. This, in turn, limits discussion to those options associated with a diagnosis that sees the situation as chronic and the solution as dramatic. The issue here is that the use of such high-stakes language crowds out discussion of solutions that are not dramatic and which do not speak to the solutions proposed by the original commentator. As Glenn Hook (1984, 262) has pointed out, the depiction of something as cancerous necessitates that both dramatic and interventionist action be taken. Likewise, the momentum of the bicycle must be maintained; the train must be prevented from coming off the rails; and a patient in terminal decline must either be treated immediately and robustly or else put out of his or her misery. The point here is that the entailments that accompany a metaphor, or for that matter the manner about which a subject is spoken, set the boundaries of what is understood to be politically possible. The message is clear: bridge the divides and conclude the round, or else the breakdown of the multilateral trading system and something akin to the nightmare of the 1930s will be upon us. Yet, the perceived urgency of the situation ensures that we continue to think inside the box, to carry on doing things just the way we have without allowing space and time for thinking about how we might solve the ills of the multilateral trading system.

The point here is that the rationale for the GATT was consciously constructed for a particular purpose. That rationale brought with it a constructed history that has since become a core part of the history of the GATT. As such, it represents only a partial, subjective and problematic account of both the GATT and the logic upon which it is based. The language deployed, particularly relating to the dangers of not pursing multilateral trade, is nevertheless sufficiently compelling and reasonably close to the historical reality to have become the received wisdom.
This, in turn, has assisted in generating and maintaining a consensus around both the GATT/ WTO as an institution and the kind of liberalization pursued therein; and, in the absence of a credible alternative, it has focused attention on settling but nevertheless persisting with the existing system rather than fundamentally overhauling its core practices and attendant principles.

Conclusion

Even the best of the earliest accounts of the genesis of multilateral trade offers a partisan narrative. This is perhaps inevitable as the telling of history is, of course, always subjective (Carr 2001, 2). It is nevertheless worth noting that, like most histories, the lenses that are deployed tend to be tinted in ways that reflect dominant ideas and interests. The standard history of the GATT is no different. Most accounts focus on the GATT as seen from the view point of Washington, London and Brussels. Few explore the role that developing countries have played, leaving aside much of the industry and energy many exerted in the GATT’s negotiation and evolution. Instead, developing countries tend to be portrayed as either determinedly negotiating relief from various commitments, focused on the pursuit of industrialization through import substitution and/or free-riding on the commitments made by their industrial counterparts, or else as ‘quiet bystanders’, lacking the expertise or political representation to participate fully or attempting to redress biases in the institution’s design (Wilkinson and Scott 2008; Scott 2010). Either way, the presentation of their participation in this way is used to encourage developing countries to reciprocate for (often inappropriate) concessions received and to become ‘paid up’ members of the trading system.

It is also worth bearing in mind that the received history of the multilateral trading system has come to dominate, in part, because alternative ideas either do not exist or else they have been discredited and in part because of the path-dependent way of thinking that this history and its underlying set of assumptions encourages. Radically different ideas of socio-economic organization have fallen by the wayside since the end of the Second World War; and, until very recently, more interventionist forms of liberalism (such as Keynesianism) had retreated in the face of neo-liberalism’s hegemony (Cerny 2008). The consensus that has emerged around the neo-liberal model has, in turn, solidified further the logic presented by the narrative of the GATT and WTO and has, inevitably, focused attention on the pursuit of minor adjustments for the sake of efficacy rather than fundamental reform. While it may well be widely acknowledged that the WTO is not working well—particularly for its least developed members—the dominance of neo-liberalism continues to underpin perceptions of the WTO as the only, or perhaps better still least ineffective, game in town.

The two stories that we commonly encounter about the GATT/WTO are not neutral, objective accounts; rather they are subjective accounts that encase a core political purpose—the advancement of a set of national trade interests—in a common sense story about the value of free trade. One of the many problems of course is that these two accounts are entirely incongruous with one another. The GATT was established as a mercantilist instrument in which some areas of commercial activity were to be liberalized while restrictions were to remain in others. This continues to be the case with the WTO. Equally, the necessity of keeping liberalization in perpetual motion is at odds with the record of trade politics wherein some areas have been opened up, others have remained protected, while others still have seen more protection emerge as other barriers to trade (particularly what are known as non-tariff barriers) have been imposed. And all of this has occurred in the absence of a slide into war. This of course does not mean that we should discard these stories as wholly meaningless. It means that we should acknowledge them for what they are: one view of how the world ought to be.
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governed. It also means that we should recognize that these two stories force us to hold in our minds simultaneously two ideas that contradict one another (Orwell 1946); that they continue to set out the terrain on which trade debate unfolds; and it is on this terrain that we must engage.

The task ahead is thus to reconstruct a trade narrative that better captures the history of the multilateral trading system, that has at its core a concern for the interests of all and which enables broader debate to occur in a less ideologically constrained fashion. Yet, it is precisely because the narratives that inform the multilateral trading system have proven to be so malleable and accommodated challenges and accounted for changes through time that they have continued to exude an appearance of relevance. Towards the close of his tenure as WTO Director-General Pascal Lamy and others in and close to the Secretariat began calling for a new trade narrative to be created (OECD 2012). In making this call they openly recognized that the existing trade discourse lacks the traction it once had; and in calling for a new narrative they explicitly drew on the need for stories about trade that take account of changes in the nature of production wherein transnational processes of manufacture and service delivery in what have come to be known as ‘value chains’ are at the forefront.

This nascent narrative serves that same purposes as the existing trade narratives alongside which it will undoubtedly sit. For developing countries to capture the benefits of the global market they must make themselves attractive as production nodes in longer chains. One part of this beauty contest is to liberalize in the same fashion that they have always been encouraged— liberalization that will almost certainly not be reciprocated in terms of meaningful market access in goods and services that matter to developing countries in industrial markets. In liberalizing, and as a result driving down the costs of production for multinational enterprises, those developing countries that are currently partially and wholly excluded from this new mode of production will begin to reap the benefits of participation. It matters not that studies of value chains show overwhelmingly that the tastier gains from being involved in such networks accrue to those to which such gains have always accrued—the industrial countries (Barrientos et al. 2011); nor does it matter that the logical outcome of a world of value chains would be one wherein gain is not evenly distributed but one where the gap between those at the top and those at the bottom will continue to expand. What matters is that this appeal to a new trade narrative that better accounts for ‘economic’ reality lends an allure of relevance and efficacy to an institution and a form of trade governance that has generated, and will likely continue to preside over, inequitable gains. Moreover, in pursuing endeavours like the Made in the World Initiative (MIWI)—which involves not only the redesign of a trade narrative around global value chains but also an education programme and a joint initiative with the Organisation for Economic Cooperation and Development (OECD) to recalculate trade data on the basis of ‘value added’ (WTO 2012) among other things—and other projects that are designed to enhance the relevance of an organization that has suffered moral-wise from the pitched battles that have been fought over trade and the seeming incapacity of the WTO to oversee the conclusion of a trade round (Wilkinson 2014), the Organization is actively engaged in securing a measure of legitimacy as the centre-point of global trade governance and representing itself as an effective, rather than a defective, institution.

The saving grace is that this new narrative has yet to be fully realized. Not since the immediate post-war years has an opportunity to construct a different trade narrative designed around a fundamentally different—and ultimately more egalitarian—way of governing global trade existed. Given the extent to which global inequalities of income, wealth and life experience are widening and threatening social stability everywhere—in which trade plays a role—it is imperative that this opportunity be taken, and that it be taken now.
Rorden Wilkinson

Notes

1 I am grateful to James Scott, Manuela Moschella and Kate Weaver for their comments on an earlier draft of this chapter.
2 Brazil, China, India, Russia and South Africa.
3 In a field so fond of acronyms their meaning can often be lost: ITO—International Trade Organization; GATT—General Agreement on Tariffs and Trade; OTC—Organisation for Trade Co-operation; WTO—World Trade Organization.
4 Three of the states chose not to sign the Charter: Argentina, Poland (both of which had previously announced their intention to abstain) and Turkey (whose delegation stated that its instructions had been delayed). Turkey signed the Charter on 26 June 1948 (ITO Report 1948, 365; 1949, 160).
5 The ITO Charter was to come into effect 60 days after just over half (27) of the signatories had ratified the document. Failing that, the Charter would come into effect if 20 states had ratified it by 24 March 1949. If by 30 September 1949 these requirements still had not been met, under the guidance of the UN Secretary-General, those states that had ratified the Charter were to be consulted to determine the conditions under which they would be willing to bring the Charter into effect. The result was to continually extend the timeframe in which signatories were able to ratify the Charter and, by so doing, elongate the institution’s demise.
6 Bergsten did not actually use the term ‘bicycle’ at first, though Jagdish Bhagwati credits him with putting forward the idea (Bhagwati 1988, 41).

References

Business as usual in the governance of global trade


Orwell, George, ‘In Front of Your Nose’, *The Tribune*, 22 March 1946.


Does sunshine make a difference?
How transparency brings the trading system to life

Robert Wolfe

Reports of the death of the World Trade Organization (WTO) are exaggerated. Even with the Doha Round of multilateral trade negotiations in suspended animation since 2011, the importance of the WTO to the daily life of the trading system is undiminished. Formal rounds of negotiations and resort to the dispute settlement system are the traditional ways of thinking about the role of the WTO, but the third dimension of ongoing WTO work, which can be broadly grouped as transparency and accountability mechanisms, may be the most important. Some think transparency is the antechamber to dispute settlement; I think dispute settlement, useful for managing a limited range of conflict, is what happens when transparency and accountability mechanisms fail. Drafting a new agreement and entertaining legal arguments about what such an agreement might mean—both forms of codification—are less important in this constructivist interpretation of social life than the interaction structured by the agreement. The focus of this chapter, therefore, is on how Members use the WTO agreements to make the trading system a living thing. Sunshine is the foundation.

The first use of sunshine as a metaphor for transparency as a policy tool is attributed to the American jurist Louis Brandeis. In writing about efforts to regulate finance, he said, ‘Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman’ (1914, 92). Americans certainly brought these ideas with them to the international organizations created in the last century, but they were not alone. Others have argued that Article X of the GATT 1947 on ‘Publication and Administration of Trade Regulations’, like the US Administrative Procedures Act of 1946, whose language it appears to replicate (Ostry 1998, 16), was based on an American belief that transparency was the best way to control the discretion of administrative agencies (Ala’i 2008, 873). Article X was partly based on Articles 4 and 6 of the 1923 International Convention Relating to the Simplification of Customs Formalities (WTO 2005, para. 3), while transparency and independent judicial review had been part of English administrative law since the 17th century (Arthurs 1985).

Sunshine as a policy paradigm is not especially novel, or American, but it is associated with the powers that once dominated the trading system. Do newer players attach the same importance to transparency? In 1980 only eight OECD member countries had legislation on access to information, but by 2004 only two of the then 30 members did not have such legislation, with
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the biggest increase coming after 1990 (OECD 2005, 36). Now such laws are spreading widely in developing countries too. Is sunshine effective in the presence of great imbalances in power and wealth? Rich countries with sophisticated bureaucracies are better able to take advantage of transparency and accountability mechanisms, but those mechanisms do bring institutional power into play, which is distributed differently than material power (Barnett and Duvall 2005). Transparency is increasing at the WTO, no doubt in part because of the transparency wave in governance generally, which extends well beyond the Atlantic core of the original GATT. Transparency matters for the ability of citizens to hold their governments accountable, but it also has its own logic in global economic governance.

In the first section of this chapter, I discuss the logic of transparency in general. In the next section I describe three generations in the evolution of transparency in the trading system as a means of explaining how transparency works in the WTO. A subsequent section explores improvements to the process of notification, mainly the ‘right to know’ policy. The last section concludes that sunshine does make a difference, but not always a positive one. While new players in the trading system seem to accept the transparency paradigm, its full deployment may be beyond the capacities of many developing countries.

Why think about transparency?

Transparency is generally accepted as both legitimate in itself and essential to modern governance (Florini and Stiglitz 2007). Transparency is often seen as part of a basic right of access to government information, a principle that has become more important, especially in OECD countries, over the last 30 years, notably with respect to environmental governance. This trend is exemplified in Europe in the 1998 Aarhus Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters. In the trading system, however, the WTO transparency norm is not directly about whether governments and other centres of authority disclose enough information to the public (Holzner and Holzner 2006). In the first instance the objective is neither to enhance the capacity of citizens nor to promote domestic objectives that can be achieved without the need for international obligations. Transparency is not necessarily a virtue in itself in trade policy terms—it is instrumental to enhancing the implementation of obligations through improved monitoring and surveillance in the WTO.

Many familiar approaches to international relations are not interested in what happens inside international organizations. Models that stress the salience of power or material interests do not expect WTO procedures to alter the interests of domestic actors. My approach belongs with those models that assume that something happens inside the international organization that alters either the understanding of themselves and their interests or preferences that participants brought to the table, or how they understand the nature of social reality in the domain. Regimes depend on the constant evolution of shared understandings of the essential rules and norms of the system. Where the social interaction essential to such normative evolution is constrained, the regime may be ineffectual; where it is robust, the regime can evolve along with a changing context (Wolff 2005; Brunnée and Toope 2010).

The WTO system changes through the day-to-day interaction of participants recognized or accommodated or encouraged through three explicit processes: discussion in a regular committee, dispute settlement proceedings and formal negotiations. Some authors stress the importance of attention to these committee processes in the WTO (Lang and Scott 2009a; Lang and Scott 2009b); others think that they are mere manifestations of underlying interests and power (Steinberg 2009). I think that what matters to eventual codification are the opportunities for the people involved to learn through talking to each other. The ultimate codification is not
necessarily the most significant ‘outcome’—the real outcome is changed expectations of mutual obligations. The point of an agreement, therefore, is not the thing itself but the capacity to generate agreement, to structure the future interaction of the parties (Soltan 1999, 396). That interaction would be empty without information.

Transparency is a representation of reality. As with a painting or a photograph, what we choose to include within the frame, and how it is portrayed, depends on what we think is important. The WTO Glossary defines transparency as the ‘[d]egree to which trade policies and practices, and the process by which they are established, are open and predictable’ (2013). The glossary definition necessarily requires choices both about how to be transparent and what to be transparent about. It refers to a number of interrelated actions, including how: a rule or a policy is developed domestically; the rule is enforced or a policy is implemented; the rule is published; the other Members of the WTO are notified of the new rule or a policy action; a notification is discussed in Geneva; and the results of the Geneva process are published. The concept of transparency refers, therefore, both to generating information and to generating agreed interpretations of the information.

The ultimate objective is reducing information asymmetries among governments, and between the state, economic actors and citizens. Acquiring information is costly, and much of the relevant information will be held asymmetrically, which can be a particular problem with contracts that are necessarily incomplete: even rational actors cannot anticipate every contingency (WTO 2007, 162–63). In this context, ‘a useful definition of transparency is the presence of symmetric information’ (Geraats 2002, F534). One way in which trade agreements make a difference to economic activity is by reducing uncertainty about policy both for trading partners and economic actors. Under conditions of ‘imperfect information’, everybody would be better off if partners reduce their asymmetrical information about each other. One of the questions in any international legal regime is the extent to which differing national laws are functionally similar, or recognizably similar. Good faith implementation of international obligations need not and does not result in identical national law. The purpose of transparency mechanisms in reducing information asymmetry is thus to allow verification by other Members that national law, policy and implementation achieve the intended objective. Even more important is creating transparency about the beliefs and intentions of actors without which no regime can function. The trading system is based on diffuse reciprocity, which requires trust, which requires transparency, part of a mutually constitutive process in which trading partners learn about each other and the nature of the system. Members work together to adjust their behaviour to the needs of the trading system, to ensure that everyone knows what the appropriate behaviour might be. Creating opportunities to discuss new measures in advance can reduce the potential for conflict between states, for example when the measure is modified to accommodate the interests of partners, and it provides time for economic actors to adjust.

A trade agreement is first a set of rules that should govern policy in a given domain. If nobody knows what the policy is, however, the agreement cannot work. Simple publication of tariff schedules, though still an essential form of transparency, is no longer sufficient. Now trading partners and economic actors need to have information about a wide range of domestic policies that have the capacity to affect the flow of transactions across borders, domestic policies that are increasingly subject to WTO obligations. An ad valorem tariff imposed at the border is transparent in itself and can readily be compared to the rate bound in a Member’s published schedules, but trading partners cannot see what is going on ‘behind the border’ without help. Domestic standards and regulations, notably those related to product safety and animal health, are hard to observe, and they are ambiguous in trade policy terms.

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How transparency brings the trading system to life

Table 3.1 Purposes of transparency

<table>
<thead>
<tr>
<th></th>
<th>Information</th>
<th>Influence/participation</th>
<th>Accountability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citizens</td>
<td>√</td>
<td>At home</td>
<td>At home</td>
</tr>
<tr>
<td>Economic actors</td>
<td>√</td>
<td>At home</td>
<td>At home</td>
</tr>
<tr>
<td>NGOs</td>
<td>√</td>
<td>At home (and Geneva?)</td>
<td>At home</td>
</tr>
<tr>
<td>Other Members</td>
<td>√</td>
<td>Geneva</td>
<td>Geneva</td>
</tr>
</tbody>
</table>

Transparency serves three purposes. First, it lets actors know what others are doing, so they can act accordingly. Information users make better choices based on new information; information disclosers improve practices in response to the changed behaviours of users. Second, it is the basis for one actor to try to influence another actor to act differently, perhaps through some form of participation. Third, it is the basis on which an actor can be held accountable for obligations, both those inherent in holding an office, and those accepted as part of some formal or informal agreement. Depending on how each of those purposes is understood, what needs to be represented will differ. Why information is made available, and for whom, affects the process. Similarly each of those purposes implies a set of relations among actors, often expressed as a multiplicity of accountability relationships. The possibly relevant actors include any individual affected by policy; economic actors trying to operate in a particular market; other governments; and citizens.

WTO obligations require both transparency at national level and transparency in Geneva. The necessary information, and the relation among actors, will differ between these locations, as summarized in Table 3.1.

The right-to-know principle applies to everybody at both levels, in the first column, but the ability to influence decisions, in the second column, and to seek accountability, differs. Accountability relations in the third column can be horizontal, including among governments, or vertical. In Geneva only governments are full participants, although NGOs have some capacity to influence debate and, as delegates of citizens, have some engagement in accountability mechanisms.

Against this complex background of the motivation for WTO transparency, in the next section I describe an analytic framework for understanding how it works. Transparency can be categorized for convenience as first-, second- and third-generation policies as shown in Table 3.2, a typology developed to think about the evolution of transparency policies in advanced economies (Fung et al. 2007), where the paradigmatic importance of transparency is now unquestioned.

The first generation is the emergence of open government or ‘right to know’ policies; the second is regulation by disclosure; and the third is e-government. When adapted for analysis of the WTO, first generation refers to the original GATT policies from 1947 as elaborated over the years, while second generation refers to the monitoring and surveillance mechanisms introduced with the conclusion of the Tokyo Round negotiations in 1979, and enhanced in the Uruguay Round negotiations that led to the creation of the WTO in 1995. Third generation refers both to managing an enlarged WTO with 159 Members and to the greater openness to the public, facilitated by the emergence of the internet, especially after a 2002 decision on access to documents (WTO 2002).

Right to know in the WTO

Citizens cannot hold governments accountable and firms cannot navigate global markets if they do not know what tariffs or rules apply, and whether they are likely to change. Governments
need to know how their trading partners are implementing their obligations. Most of the first-generation WTO transparency provisions listed in Table 3.3 relate to the obligations incumbent on governments for trade policy transparency at home.

The basic right-to-know principle (1) is publication of all trade-related international obligations, most notably the codification of Members’ specific mutual obligations in the thousands of pages of ‘schedules’ attached to the general obligations of the WTO agreements. Data on bound tariffs is now available on the WTO website in the Consolidated Tariff Schedules database, and a growing share of Members’ applied tariffs is available in the Integrated Data Base (Bacchetta et al. 2012, 19).

Table 3.2 Transparency generations

<table>
<thead>
<tr>
<th>Generations</th>
<th>Principle</th>
<th>WTO example</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Right to know</td>
<td>Mandate access to most government processes and files with the general aim of informing the public and guarding against arbitrary government action.</td>
<td>Allow governments and economic actors to know the trade policy environment at home and abroad.</td>
</tr>
<tr>
<td>2. Targeted transparency, or monitoring and surveillance</td>
<td>Mandate access to precisely defined and structured factual information from private or public sources with the aim of furthering particular policy objectives.</td>
<td>Move government actions in direction of consistency with implicit norms and explicit obligations of the trading system.</td>
</tr>
<tr>
<td>3. Collaborative transparency, or reporting</td>
<td>Employ new technologies to combine information from first- and second-generation policies with a new user-centred orientation.</td>
<td>Combine first- and second-generation results in a user-friendly format so that the public can readily understand more about what states and firms are doing.</td>
</tr>
</tbody>
</table>

Source: Based on Fung et al. (2007, 25)

Table 3.3 WTO right-to-know provisions

<table>
<thead>
<tr>
<th>Principle</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Publication of international obligations</td>
<td>GATT Article II; GATS Article XX (schedules); trade agreements</td>
</tr>
<tr>
<td>Publication of laws and regulations</td>
<td>GATT Article X; GATS Article III:1; TRIPS Article 63</td>
</tr>
<tr>
<td>Enquiry points for trading partners and economic actors</td>
<td>SPS; TBT; GATS Article III:4</td>
</tr>
<tr>
<td>Independent administration and adjudication, including rights for foreign firms</td>
<td>GATT Article X; GATS Telecoms reference paper; Agreement on Government Procurement, Articles XVIII and XIX</td>
</tr>
<tr>
<td>Notification through WTO</td>
<td>Notifications can be classified by the form they take or by the use to which they are put in WTO</td>
</tr>
</tbody>
</table>

Source: An earlier version of this table was in Collins-Williams and Wolfe (2010); for a legal description of the provisions see Ala’i (2008)
How transparency brings the trading system to life

Equally important for economic actors are the many provisions requiring publication of all legal requirements affecting trade (2), and publication in sufficient time for anyone affected by the rules to know about them before they come into force, both to allow time to comment and time to prepare to take advantage of the new opportunities created. ‘Notice and comment’ provisions are common in many administrative law systems. The WTO obligation is first to do it domestically, and then to extend the same courtesy to trading partners.

Given the complexity of measures affecting trade, some agreements require the establishment of an Enquiry Point (3), where other Members can obtain information on domestic regulations. The GATS even provides for the establishment of ‘contact points’ where private companies from developing countries can obtain relevant information. An important right-to-know obligation is having regulators who are independent of the executive (4), whose actions are therefore made more visible. This principle is first seen in the GATT/WTO system in Article X of GATT 1947, but it is also found in other WTO agreements, most obviously Government Procurement, where transparency before and after the fact is meant to discipline the discretionary award of government contracts. Arms-length administration is an essential aspect of the competitive principles for services regulation embodied in the Reference Paper for the basic telecoms agreement.

All of the preceding right-to-know provisions are subject to notification requirements (5), as listed in part A of Table 3.4.

In the WTO Glossary, a ‘notification’ is defined as ‘a transparency obligation requiring member governments to report trade measures to the relevant WTO body if the measures might have an effect on other Members’ (2013). The requirements are all inherently ambiguous, in that Members are asked to notify something that other Members might find negative, from a new food safety rule to the level of subsidies to farmers. The basic principles were codified at the creation of the WTO, based on GATT practices that had been evolving since 1947 (Bacchetta et al. 2012). In one of the ‘decisions’ adopted at the end of the Uruguay Round (WTO 1995), Members recalled the general obligations to notify, ‘such notification itself being without

Table 3.4 Types of WTO notifications

<table>
<thead>
<tr>
<th>A. Self-reporting</th>
<th>Information provided by an actor on its own behaviour</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘One time only’</td>
<td>Notification of laws, regulations or other measures implementing WTO obligations at a time specified in the agreement</td>
</tr>
<tr>
<td>Ad hoc</td>
<td>Some notifications are required when Members take or propose to take certain actions—e.g. new standards in SPS, or new measures in ILP</td>
</tr>
<tr>
<td>Regular or periodic</td>
<td>Many agreements have requirements for regular notification, like ASCM, Agriculture</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B. Other-reporting</th>
<th>Information provided by an actor on other actors’ behaviour</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reverse notification</td>
<td>Many agreements allow Members to notify measures that they think a trading partner should have notified, which then creates the basis for peer review, but such provisions are rarely used</td>
</tr>
<tr>
<td>Dispute settlement</td>
<td>The formal complaint that launches a dispute is a form of other-reporting</td>
</tr>
<tr>
<td>Third parties</td>
<td>Many sources are used by the Secretariat in the crisis monitoring reports, with a request for ‘verification’ by Members—these reports often have better and more recent data than other WTO sources</td>
</tr>
<tr>
<td></td>
<td>Provisions on RTAs allow the secretariat to draw information to the attention of Members</td>
</tr>
</tbody>
</table>
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Table 3.5 Notification obligations as of 2011

<table>
<thead>
<tr>
<th>Category</th>
<th>Regular</th>
<th>Ad hoc</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development</td>
<td></td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Government procurement</td>
<td>3</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>Intellectual property</td>
<td>3</td>
<td>23</td>
<td>26</td>
</tr>
<tr>
<td>Services</td>
<td>3</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Trade in goods</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>8</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td>Market access</td>
<td>9</td>
<td>27</td>
<td>36</td>
</tr>
<tr>
<td>Rules</td>
<td>7</td>
<td>34</td>
<td>41</td>
</tr>
<tr>
<td>Technical barriers to trade</td>
<td>1</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>TRIMs</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>General</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance of payments</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>RTAs</td>
<td>6</td>
<td>0</td>
<td>6</td>
</tr>
<tr>
<td>TPRM</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>42</td>
<td>134</td>
<td>176</td>
</tr>
</tbody>
</table>

Source: WTO (2011b, Box 1)

prejudice to views on the consistency of measures with or their relevance to rights and obligations. They established a Central Registry of Notifications to receive and maintain the notifications, to inform each Member annually of their regular notification obligations and to draw the attention of individual Members to regular notification requirements that remain unfulfilled. As shown in Table 3.5, the central database now covers 176 notification requirements, of which 42 are recurring requirements (semi-annual, annual, biennial, triennial).

Current data based on formal notifications are inadequate in two dimensions: it can be hard to know if the notified data are accurate, or complete, especially for non-tariff measures (WTO 2012b); and real-time monitoring is hampered by late notifications. In response to both inadequacies, Members have assigned the Secretariat of the Trade Policy Review Body (TPRB) an increasingly active role. The core of each TPRB report is based on the notifications of the Member under review, but each report depends on a far wider range of data and information than is available from official WTO notifications, represented in part B of Table 3.4. The Secretariat collects these data from official sources (questionnaires to the Member under review) and non-official sources. The use of data collected in this way is a form of other reporting, or ‘reverse notification’. To ensure accuracy, the Secretariat seeks verification of the data and information when discussing the draft of its report with the Member (WTO 2011b, para 180).

The crisis monitoring reports and annual reports on the trading system use a similar method, but the 2012 mid-year monitoring report notes that ‘Replies to the request from the Director-General for information on measures taken during the period under review were received from less than 20% of the total number of Members and Observers’ (WTO 2012a, para 18). At the 2011 ministerial the European Union (EU) failed to gain support from other Members for a proposal to improve adherence to notification commitments, although Members did promise to ‘comply with the existing transparency obligations and reporting requirements needed for the preparation of these monitoring reports, and to continue to support and cooperate with the WTO Secretariat in a constructive fashion’ (WTO 2011c).

Notification is the means of assembling detailed high-quality information on the trading system and the trade policies of WTO Members, but it does not work as well as it should. At
the end of September 2011, only 20% of the Members were in full compliance with their agriculture notification obligations up to the end of 2009. In one recent year, for another example, only 22 GATS notifications were received, from four Members (WTO 2011b).

Four sorts of reasons can be advanced as an explanation of why governments do not improve notification. The first is bureaucratic incapacity, which is the case for many developing countries that lack the data, knowledge or clout with other departments to generate the notification. The second is a refusal to see information as a public good. One Secretariat official argues privately that governments do not value information enough, or that they value it too much, but in the wrong sense. That leads to a third reason, a conscious unwillingness to notify, which may be the case for subsidies issues, where Members might worry about opening themselves to criticism, perhaps in a dispute; or where a notification might require showing one’s cards in a negotiation. And yet everybody would like to have information about their partners. The final reason advanced for poor notification is an inability to characterize an issue in WTO language, which is perhaps the case with emerging issues, like green subsidies, or issues where Members still lack an agreed definition of the issues.

More positively, one can think of circumstances under which Members are more likely to notify (Collins-Williams and Wolfe 2010). The first is evident benefits: providers of information must see how doing so helps them meet their own objectives. Do they believe that the information they provide will be analysed, aggregated and disseminated in a way that is helpful to them or crucial for the regime? It follows that notification is better where the text of the agreement is clear, and well-understood, perhaps because of extensive ongoing participation by the responsible authorities in WTO discussions, and when the notification format is easy to complete. Notification is also easier when the same agency is the authority for a measure, is responsible for notification and is the user of the results in the WTO.

This last factor may be critical, as we will see in the next section. The experts from capitals who attend technical barriers to trade (TBT) and sanitary and phyto-sanitary (SPS) meetings are the people who must provide notifications and who rely on other countries’ notifications. In the Subsidies Committee (SCM), in contrast, the Geneva-based delegates typically report to treasury ministries, who have a very different interest in the use of public money in their own and other countries than operational ministries or sub-national governments. Fewer experts from capitals attend the Agriculture Committee, and capital-based attendance is rare for import licensing (ILP), and GATS has no committees that would engage experts from capitals in a review of complex notifications.

**Monitoring and surveillance**

Some WTO notifications are effectively ‘tombstone’ data because no discussion takes place, but some are linked to the possibility of review by a relevant WTO body before or after the measure takes effect. Second-generation transparency at WTO refers, therefore, to a set of monitoring and surveillance mechanisms listed in Table 3.6.

Monitoring means any activity where Members review each other’s implementation of the agreements. The meetings are opportunities for Members to learn more about the incidence of a particular policy (e.g. subsidies) and understand the reason for their use. Surveillance might focus on checking whether governments have created national legislation that incorporates an agreement into law; or on whether those laws are adequately enforced. Monitoring takes place in the various WTO committees, often with an opportunity for Members to ask each other questions about notifications and sometimes with a formal ‘Specific Trade Concerns’ (STC) procedure, as discussed below. Peer review is also found in the Trade Policy Review
Mechanism (TPRM), which aims at ‘achieving greater transparency in, and understanding of, the trade policies and practices of Members’. Discussion in the TPRB is based on major reports written by the WTO Secretariat and the Member under review (WTO 2011b, para 178 ff). The reports, and a record of the discussion, are subsequently published, as is the Director-General’s annual report to the TPRB, an overview of developments in the international trading environment.

Members created a new mechanism in response to the Great Recession that began in 2008. After the G-20 asked the WTO and other international organizations to monitor their collective commitment to avoid protectionism, the WTO began issuing periodic crisis monitoring reports, a novel extension of the mandate of the TPRB (WTO 2012a). The Director-General claimed that he had the authority under the WTO agreements to conduct the crisis monitoring, but Members only formalized this role in December 2011 (WTO 2012b). One factor that contributed to legitimizing this more autonomous role for the Secretariat was simply experience with the mechanism. Members discovered that the periodic Secretariat reports were factual and useful, especially for smaller Members who could not begin to generate such data on their own, and that the Secretariat was not trying to build a new form of dispute settlement through the back door.

One of the ultimate purposes of transparency is to ensure accountability for commitments, in this case by governments holding each other to account (Wolfe 2011). As a result of questions and challenge in a committee, a government may provide more information, change policy, or pressure other units of government to respond. Beyond holding each other to account, governments also use the WTO as a forum for intervening in the design of another government’s regulations. They act in part on behalf of economic actors in their country who may be affected by new regulations—engagement with regulatees usually diminishes potential conflict, while leading to better regulation. In this sense the practices of WTO committees, notably SPS and TBT, make for stronger and more extensive governance networks (Downes 2012, 523).

Transparency can also be seen as educational: when actors receive new information about themselves, they may adopt new behaviours (Mitchell 2011, 1882). Governments are then assumed to be likely to change their behaviour because they learn about the benefits of socially acceptable policy action. (Related ideas are found in the liberal convergence literature—see Simmons et al. 2006). The extent of such learning, however, is limited by the small number of Members to whom questions are addressed in committees and by the small number of active questioners. Delegates from small countries ask questions sent by capitals, and not always well-informed questions. Collins-Williams and Wolfe (2010) found in Subsidies and Agriculture that a small number of Members consistently ask questions, and are also consistently targets

### Table 3.6 WTO monitoring and surveillance mechanisms

<table>
<thead>
<tr>
<th>Principle</th>
<th>Examples</th>
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<tbody>
<tr>
<td>General clarity in domestic trade policy</td>
<td>Trade Policy Review Mechanism</td>
</tr>
<tr>
<td></td>
<td>– country reviews</td>
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<td></td>
<td>– Annual Report</td>
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<td>– monitoring reports</td>
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<tr>
<td>Peer review</td>
<td>Committee review</td>
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<td></td>
<td>– “specific trade concerns” in SPS, TBT</td>
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<tr>
<td></td>
<td>– similar procedure in ASCM, Agriculture, ILP, GATS</td>
</tr>
<tr>
<td>Third party adjudication</td>
<td>Dispute settlement system</td>
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</tbody>
</table>

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(notably Canada, the USA, the EU, Australia and New Zealand), yet having to think your way through an answer to a question is also a form of learning. In Agriculture, Canada and the EU make a point of trying to ask questions of smaller Members, because it helps them learn. The Trade Policy Review Body must deal with 26 country reports a year, so most questions from Members will be planted by the Secretariat. Countries with well-developed domestic transparency mechanisms, and strong analytic capacity, are also best able to participate in Geneva. TPRB questioning is dominated by a few large Members, most notably the USA and the EU (Ghosh 2010). Asking questions depends on knowledge and expertise that smaller countries may lack, yet Members who do not engage in the deliberative process will learn less about the rules and the process than those that do. While the ability to engage in the process may not have been a major preoccupation of the Atlantic countries that created the GATT in the 1940s, it is increasingly critical now.

Reporting and engagement

Third-generation transparency is represented at the WTO by greater attention to what is done with the information available. Information is aggregated in new ways and made more readily available. Reporting and engagement groups a set of practices on how the WTO reports on its work, and efforts to create an inclusive decision-making process so that everyone has access to and can use information. This dimension has greatest relevance for civil society, for smaller developing countries and for less developed countries (LDCs), which may not have the capacity to analyse the right-to-know information, or be full participants in monitoring and surveillance mechanisms. Rather than producing information, then, this type of transparency, as shown in Table 3.7, is more about communicating information and listening to the views of stakeholders. This aspect of WTO work is the focus of critics who see the WTO as undemocratic, arguing that civil society cannot properly participate in the organization and that many small countries are severely disadvantaged by the WTO’s practices.

With what is sometimes called collaborative transparency, the internal challenge is to create a more inclusive decision-making process in Geneva, ensuring that all Members have and can make use of information. Whether developing countries have the capacity to analyse the information generated by the transparency mechanisms affects both the operation of existing

Table 3.7 Reporting and engagement

<table>
<thead>
<tr>
<th>Principle</th>
<th>Examples</th>
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<tr>
<td>Internal transparency for Members</td>
<td>– Rules of procedure for committees and negotiations</td>
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<tr>
<td></td>
<td>– Extensive reporting on STCs in TBT and SPS</td>
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<td></td>
<td>– Database of questions and answers in Agriculture</td>
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<td></td>
<td>– Minutes of questions and answers in ASCM, ILP</td>
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<tr>
<td>External transparency for citizens and economic actors</td>
<td>– Documents publicly available on the website</td>
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<td></td>
<td>– Publish TPR reports, WTO Annual Report, and annual World Trade</td>
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<td></td>
<td>Report-Development of a searchable ‘umbrella’ database of all</td>
</tr>
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<td></td>
<td>notification, STCs, questions and answers in committees and in TPR</td>
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<tr>
<td>Role for NGOs</td>
<td>– Annual Public Forum</td>
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<td></td>
<td>– <em>Amicus Curiae</em> briefs</td>
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<td></td>
<td>– Limited use of third-party data</td>
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agreements and new negotiations. Where standards are concerned, having the capacity to 
understand the science and influence the evolution of new rules is also a factor for developing 
countries.

As to external transparency, the challenge is to enable better policymaking in capitals, enga-
ging both economic actors and citizens. Domestic transparency, including an active process of 
seeking information from economic actors and consulting citizens, can be daunting (Halle and 
Wolfe 2007). Even helping people outside the WTO understand what is going on inside takes 
effort (Bonzon 2008). Encouraged by environmental NGOs, meetings of the Committee on 
Trade and the Environment were the first to use the internet to make the results of the meet-
ing quickly accessible to the public (Shafer 2001, 75). By 2002, Members had agreed that all 
ofﬁcial WTO documents should be available to the public on the WTO website, including 
minutes of meetings, dispute settlement reports and the results of negotiations (WTO 2002). In 
practice Members have found myriad ways around these ﬁne principles. The rules apply only to 
documents in an ofﬁcial WTO series, but the most sensitive issues in negotiations often surface 
ﬁrst in un-numbered ‘room documents’ handed out during a meeting (available on a separate 
internal website), or in documents with the ‘JOB’ code that are generally not made available on 
the website. Documents on ‘accession’ to the WTO are released only when the working party 
created to examine an application reports to the General Council, but the negotiations can drag 
on for many years, without the public formally knowing what is going on. Draft dispute set-
tlement reports are released to the parties to a dispute long before they become generally 
available, and the submissions of the parties may never be released (Marceau and Hurley 2012).

The WTO has learned to be more engaged with civil society (Esteve 2012), although, with 
the exception of amicus curiae briefs in the dispute settlement system, NGOs have no ability to 
speak direct in any WTO meeting. Most meetings, including most dispute proceedings, are 
closed to the public, although the WTO dispute settlement system is considerably more open 
than comparable economic international organizations (Marceau and Hurley 2012). In many 
environmental agreements, in contrast, NGOs are directly engaged in the work of the organi-
zation, notably CITES, where NGOs like TRAFFIC help gather additional information that 
the organization’s transparency mechanisms may miss while providing on-the-ground support 
and resources within states (Wolfe and Baddeley 2012). The WTO could make much more 
effective use of such third-party information. In the case of crisis monitoring, for example, the 
Secretariat made use of data published by the Global Trade Alert, but did not have any kind of 
formal or systematic engagement with this NGO (Wolfe 2012).

Having in mind GATT practice, Members discussed the need for annual reporting as soon as 
the WTO was created (WTO 1995). Subsidiary bodies are to report either to the respective 
sectoral Councils (Goods, Services and TRIPS—Trade Related Investment Measures), or 
directly to the General Council, which itself must prepare a report. The required reports are to 
be factual in nature, containing an indication of actions and decisions taken. The Secretariat is 
also required to report annually on compliance with notiﬁcation requirements by country and 
by agreement (WTO 1996), but the report is opaque to all but experts (WTO 2011d). And of 
course the Secretariat reports to the Committee on Budget, Finance and Administration. All of 
this information provides the basis for the relevant discussion, which may be more anodyne, in 
the WTO Annual Report, which is aimed at the interested public.

WTO Members are committed to making information available in Geneva, but that information 
is largely a by-product of information otherwise generated by the WTO transparency 
mechanisms that serve Member governments. Only some information is published with civil 
society organizations, economic actors or citizens in mind. For example, the Trade Policy 
Review reports are written for Members, and in a specialist language, but the summary
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observations are written for a general audience. When a Member wishes, more active steps will be taken to disseminate the results at home. The crisis monitoring reports are explicitly aimed at Member governments, but the Secretariat has been working hard to report the results on the internet in a way that makes complex data readily accessible to an interested but not necessarily professional audience. Many of the reports on committee meetings are also increasingly informative.

Conclusion: Does sunshine make a difference?

Transparency is the foundation for the trading system as a living thing, not just a legal text stored in a Geneva filing cabinet. Some think transparency is the antechamber to dispute settlement; I think dispute settlement, useful for managing a limited range of conflict, is what happens when transparency and other accountability mechanisms fail. We have seen that the WTO’s windows on its Members and on the trading system are cloudier than they ought to be. But they are not equally cloudy. The notification of obligations and the monitoring procedures are a disappointment in some areas and for some Members, and excellent in others. Transparency does contribute to accountability for commitments, and informal mechanisms can be more effective than formal dispute settlement, but not all Members use either one, and neither is useful in all circumstances.

Sunshine may well be the best disinfectant, as Brandeis wrote, but too much sunlight can be harmful. Transparency might hurt if it encourages posturing by negotiators and politicians. If constituents perceive a negotiation as purely distributive, they will be critical of a negotiator who pursues the possibility of an integrative outcome. Thompson (1998, 159) suggests that, given the natural desire to save face, ‘[n]egotiators who are accountable to constituents are more likely to maintain a tough bargaining stance, make fewer concessions, and hold out for more favorable agreements compared to those who are not accountable’. The transparency that modern governance demands undermines the privacy essential for negotiations (Stasavage 2004). It might also undermine liberalization, or force protection into less transparent forms (Kono 2006).

The tough questions are always: Transparency for whom and to what end? What causes a problem that transparency can remedy? More than simply making information available, second-generation policy tools, also known generically as ‘regulation by disclosure’, try to use information to achieve policy objectives more readily than through other types of tools, such as regulatory standards or formal adjudication. The assumption is that some interested public will respond to information in a way that changes a targeted actor’s behaviour. If the obstacles in a given market are understood, economic actors can make alternative decisions, which might induce the government to change policy to maintain the benefits of investment. Such illumination might also generate domestic political pressure for change.

People easily muddle the distinction between transparency as a tool for governments and its benefits for economic actors. On the one hand, an emerging body of literature conjectures that greater transparency improves trade flows (Lejarraga 2011; Helble et al. 2009), perhaps by reducing fixed or sunk costs and policy uncertainty (van Tongeren 2009; Handley and Limão 2012). Transparency about product quality through ISO (International Organization for Standardization) certification (labels are a form of transparency) increases developing country exports (Potoski and Prakash 2009). Still, some argue that imperfect information may not be much of a problem for the US economy (Winston 2008). Moreover, it would be naïve to think that transparency achieves its effects in isolation. As Stiglitz (2010, 27) observes, for example, disclosure requirements may need to be buttressed by regulations that require or prohibit certain actions. On the other hand, transparency is invaluable for governments to understand...
policy changes made by their trading partners and to observe the implementation of multilateral obligations. Information asymmetry exacerbates power imbalances between governments. By reducing such information gaps, the WTO helps to level the playing field. Transparency was the central component of the novel accountability mechanism that Members developed to restrain protectionist impulses associated with the Great Recession (Wolfe 2012).

Will such tools remain effective as power shifts to the emerging economies? The relation between the environment and trade could be said to be a preoccupation of rich countries. If so, one might expect that new WTO Members would attach less importance to related transparency mechanisms than the original Members who drafted the rules. The assumption can be probed with the database of TBT STCs. Figure 3.1 shows the increasing number of such concerns raised each year. The USA and the EU are the target of nearly 55% of environmental TBT STCs but are complainants in only 27%. Almost a quarter of all environmental TBT STCs are developing countries raising issues with EU and US measures. Initiating an STC may be easier than submitting one’s own notification, so a different probe is to query the database of all environment-related notifications in all WTO agreements (WTO 2010) with a focus on China, the most important emerging power.

For convenience Figure 3.2 reports only TBT notifications, probably the most important for environmental matters, which in most years are between 9% and 13% of all notifications.

The dark line in the figure shows, on the right-hand scale, the absolute number of notifications; and the bars show, on the left-hand scale, the share of the EU, USA and China in the total. Since it joined in 2001, China has submitted over 850 TBT notifications, many of which are environmental notifications, in some years exceeding the more established Members. Of course it has been said that China emphasizes codification rather than implementation—the government may find it easier to file WTO notifications than to make real changes in how things work.

Figure 3.1 Number of TBT specific trade concerns raised per year
Source: (Chart 4 in WTO, 2013)
Nevertheless, in the final ‘transitional review’ by the TBT Committee, other Members praised China for making many of its regulations and policies more transparent and predictable (WTO 2011a). Chinese governance is not as transparent as more established Members might like, but WTO-documents are a mine of information about the domestic administration of standards and conformity assessment. Members would like to know more, and would like the administrative procedures to be more open and accessible to foreign firms, but much of what Members know that they find problematic about China’s practices they know because of WTO transparency. To take a different example, China has learned through participation in the Trade Policy Review process, willingly responding to questions in most areas of policy. They still react conservatively to requests for transparency in some areas that they think sensitive such as subsidies or government procurement—their cultural predisposition to secrecy is the obverse of the American obsession with sunshine.

Making transparency work matters because the WTO evolves and grows first through ongoing discussion among Members, not through episodic codification in rounds of negotiations or dispute settlement decisions. Many scholars have observed that the norms that have emerged in the committee now shape the governance of this domain more comprehensively than the formal rules (Downes 2012, 521). Members that do not know how to fill out a notification, or ask and answer questions in the committees, are not full participants in its evolution and cannot reap its full benefits at home. Developing country hesitancy about transparency is an obstacle to improving the mechanisms and making better use of them. But if transparency is a benefit, then the WTO needs to find ways to help.

Transparency about trade policy is a minor subset of transparency in governance generally. Transparency can comprise many instruments, each of which embeds paradigmatic assumptions about the relations between citizens and the state. Countries that struggle to make information available at home may not be able to provide any more of it to the WTO. Transparency is straightforward for Members where such provisions are a normal part of the domestic regulatory process, but more difficult for some developing countries (Wolfe 2003). Being transparent may be good for governance, good for trade and good for investment, but complying with WTO rules may not be the prime motivation.

Third-generation transparency policies reflect an awareness that it is now harder for ordinary people in every country to understand and observe the administration of public affairs, in
general, so Progressive era ideas about sunshine alone as the best disinfectant are no longer sufficient (Hacker and Pierson 2011, 155). Where once we could imagine that citizens could monitor politicians and sanction them effectively through voting in elections, such simple delegation models no longer describe political reality in a complex policy environment. Citizens find it even harder to hold international organizations to account, but WTO monitoring and surveillance can be seen as a kind of horizontal accountability, where governments hold each other accountable for their obligations. Such accountability requires the kind of transparency described in this chapter. Transparency is therefore essential for global economic governance.

Note

1 Parts of this chapter are derived from Collins-Williams and Wolfe 2010 as adapted in Halle and Wolfe 2010. This chapter benefits from unattributed confidential interviews with WTO delegates and officials in Geneva. I am grateful for the research assistance of Alina Kwan and for the support of the ENTWINED research consortium, a project funded by the MISTRA Foundation of Sweden.

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Adaptation and change in EU trade governance

The EU’s paradigm shift from multilateralism to regionalism and bilateralism

Eugénia da Conceição-Heldt

Introduction

European Union (EU) trade governance has undergone a radical shift. Until the first temporary suspension of the Doha Round in July 2006, multilateralism was the centrepiece of EU trade policy. To be sure, preferential trade agreements (PTAs) have always been a part of EU trade policy, but it was only with the publication of *Global Europe: Competing in the World* in 2006 that the EU shifted its trade policy towards regional and bilateral trade agreements. Disappointed with the slowness of multilateral trade negotiations, EU member states gave the Commission a negotiating mandate to resume negotiations with Mercosur and to begin bilateral trade negotiations with the ASEAN countries, South Korea, India, China, Russia, Canada, Central America and the Andean countries. In contrast to negotiations at the multilateral level, when negotiating bilaterally, the EU linked trade agreements with conditionality rules on democratic principles and human rights.

This chapter argues that the shift in EU trade governance shows that, when negotiating at the bilateral level, the EU makes use of its (material) asymmetrical bargaining power (such as its market size) to obtain concessions from other bargaining parties and its social power by setting standards, creating norms and values and imposing specific conditions on weaker bargaining parties. The first section of this chapter gives an overview of EU trade policy with special focus on how and why the EU joined the run towards bilateral and regional trade agreements and what are the most important political-economic issues that have contributed to fostering regionalism to the detriment of multilateralism. The second section focuses on the EU’s role in the global trade regime. This section shows how the EU is able to exert influence and to use its power to have certain policy paradigms (such as multifunctionality in agriculture) included in the negotiating agenda of the Doha Round. The third and fourth sections illustrate the EU’s shift towards regionalism and bilateralism and how it uses its material and social power in block-to-block negotiations (EU–Mercosur) and bilateral trade negotiations (EU–Mexico).
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Evolution of EU trade governance

The EU is a major trade power and has the most extensive and complex patchwork of trade agreements with outside countries (Panagariya 2002). At the same time, multilateralism initially was the favourite EU trade strategy until the first suspension of the World Trade Organization (WTO) negotiations in July 2006 (Jacoby and Meunier 2010; Lamy 2002). From 1999 to 2006, the EU’s approach to multilateralism versus regionalism or bilateralism in trade policy was to pursue all ongoing negotiations on PTAs, but, in general, not to start any new talks (Lamy 2002). This new trade policy doctrine of ‘managed globalization’ (Jacoby and Meunier 2010) under the then trade commissioner Pascal Lamy (1999–2004) comprised two strategies: first, to show its commitment to multilateralism, since the EU informally adopted a ‘moratorium’ on beginning new PTA negotiations until the end of the Doha Round (Meunier 2007); second, the EU would consider region-to-region PTAs as stepping stones in multilateralism, since they involve ‘deep integration’ (Lamy 2002).

To be sure, bilateral trade relations and PTAs have always been a part of EU trade policy; it was only with the publication of *Global Europe: Competing in the World* in 2006 that the EU shifted its trade policy towards regional and bilateral agreements (European Commission 2006). EU member states gave the Commission a mandate to resume negotiations at the bilateral and regional levels. In the meantime, the EU has concluded PTAs with Mexico, South Africa, Chile, South Korea and the Andean Community countries (Peru and Colombia). At the same time, the EU is negotiating PTAs with Mercosur, ASEAN, India, China, Russia, Canada, Ukraine, Central America, Singapore and Malaysia (European Commission: Directorate-General Trade 2011a, 2011b). Thus, PTA negotiations include regional or block-to-block and single-country arrangements.

Although officially committed to multilateralism, the EU has always pursued a dual approach to negotiating PTAs with some neighbouring countries or with former colonies of member states. This included the signature in 1970 of an additional protocol with Turkey to establish a customs union; bilateral PTAs with three out of four European Free Trade Association (EFTA) members (Iceland, Norway and Liechtenstein) in the 1970s; the negotiation of the Lomé Convention in 1975, which granted non-reciprocal preferential treatment to African, Caribbean and Pacific (ACP) countries; and the 1976–77 cooperation agreements with Maghreb and Mashreq countries on a unilateral basis (Woolcock 2005). The objective behind a number of these PTAs was to establish closer and more stable economic relationships with neighbouring countries. Security and political stability and immigration considerations also influenced negotiations (Tharakan 2002).

By now, the EU is a major actor in negotiating a range of trade arrangements. We can distinguish at least seven different types of EU trade regimes with varying levels of integration. First, the EU with its single market is a preferential arrangement between its member states with a common external tariff. Second, the agreement on the *European Economic Area* (EEA) extended the single market to three EFTA countries without EU membership. However, there is a crucial difference between the EU and the EEA. While the EU is a customs union with a common external tariff and a common trade policy, the EEA is a free trade area with each member retaining separate tariffs. Third, the EU has agreements in place for the establishment of customs unions, albeit only for industrial products, with Andorra, San Marino and Turkey. Fourth, the EU has a large number of free trade area arrangements at different stages of implementation with countries such as Chile, the Faroe Islands, Mexico, Peru and South Africa (European Commission: Directorate-General Trade 2011a). Fifth, the EU has Mediterranean partnerships with 12 Mediterranean countries that grant them non-reciprocal access (on the
basis of contractual preferences) to the European single market. Among these are three Maghreb countries (Morocco, Algeria and Tunisia) and six Mashreq countries (Egypt, Israel, Jordan, the Palestinian Authority, Lebanon and Syria). Sixth, under the generalized system of preferences, the EU offers reciprocal trade preferences to ACP countries. These countries have privileged market access to the EU without requiring them to open their own markets. Because these preferences apply only to ACP countries, they violate WTO rules and are only granted under waiver by other WTO members (Panagariya 2002). Finally, the EU has purely most favoured nation treatment agreements (tariffs apply uniformly to only these countries) with Australia, Canada, Japan, New Zealand, Taiwan, Hong Kong, Singapore, Russia and other former Soviet bloc countries, and the USA. At the same time there has been a gradual paradigm shift in EU development policy towards incorporating aid with conditionality and reciprocal liberalization, in particular with least developed countries (henceforth, LDCs) (Farrell 2005). The EU uses its ‘normative power’ (Manners 2002) by demanding greater accountability from LDCs and the adoption of norms, rules and principles that include good governance, democracy, human rights and rule of law.

These preferential agreements correspond to three different waves of regionalism in EU trade policy. The first in the 1960s and 1970s was a response to the establishment of the common market and associated agreements with the EFTA countries, former colonies of EU member states under the so-called Yaoundé Convention (subsequently replaced by the Lomé treaties), and co-operation agreements with the Mediterranean countries. At the beginning of the 1990s, the second wave of regionalism was stimulated by the objective of enlarging the EU to include 10 Central and Eastern European countries. Finally, the third wave of regionalism consists in negotiating PTAs with developing and developed countries (McQueen 2002). Especially since February 2010, under the leadership of the new trade commissioner Karel de Gucht, there has been a move to consolidate the EU ‘Global Europe’ trade agenda through the new ‘2020 Trade Strategy’ with its focus on either completing bilateral trade negotiations or improving European investment policy (European Commission 2010). This new trade strategy of the EU emphasizes the role of trade policy as a promoter of the EU’s global competitiveness. The ‘Europe 2020’ macroeconomic strategy prepared by the European Commission and approved by member states in June 2010 was a direct response to the wider economic effects of the 2008 financial crisis. The main rationale behind ‘Europe 2020’ was basically to implement long-term economic reform with three mutually reinforcing objectives of ‘smart growth’ by developing the knowledge economy, ‘sustainable growth’ through greater resource efficiency, environmental competitiveness and ‘inclusive growth’ through employment and social cohesion (European Council 2010).

The EU and the global trade regime

The EU has never been a leader like the USA in the global trade regime (Messerlin 2012). To be sure, the EU does exert influence in the world trade system by bringing certain issues into the negotiating agenda. In addition, due to its market size of nearly 500 m. consumers, the EU is one of the most important players in the global economy. But there are signs of regulatory protectionism, especially on product standards. Some examples include the introduction of the multifunctionality principle in agriculture and the inclusion of geographical indications for agricultural products.

In the global trade regime, asymmetries in structural power determine the winners and losers of trade negotiations. Bargaining power is a function of the size of one’s market and one’s dependency on the economy of the counterpart. The larger the internal market of one power
relative to other trading partners, the greater the negotiator’s power is expected to be (Clark et al. 2000, Odell 2000). For example, with the creation of the customs union, during the Kennedy Round (1963–67), the EEC was able to use its ‘market power’ to obtain tariff reductions from the other trading partners. With the European single market and several enlargements, the EU market power increased in the 1980s and early 1990s (Woolcock 2010).

Until the mid-1990s, trade liberalization negotiations had been dominated by the USA and the European Community (EC). Bergsten (1998) even describes the history of the post-war global trade regime in terms of the power relationship between these two actors. Moreover, he considers that the key motivation for the USA to launch the different trade rounds was the creation of the European Economic Community (EEC) in 1957, the first enlargement in 1973 and the single European market. For Baldwin (2006a) one of the major preconditions for further liberalization is economic growth, which was particularly evident in the EC in the post-war period. The EC’s objective of completing its internal market by pursuing a rule-based and liberal trade approach coincided with the Uruguay Round (1986–94). Together with the USA, Japan and Canada, the EC shaped the international trade regime. The EC supported a rule-based multilateral trading system with a dispute settlement mechanism, the creation of an international trade organization and the inclusion of new issues in the negotiations such as services, investment and intellectual property rights.

Until the conclusion of the Uruguay Round, trade cooperation took place in the framework of the General Agreement on Tariffs and Trade (GATT) and since 1995 in the WTO. The main objective of the WTO is to promote trade liberalization by reducing tariff rates for imported goods and services, for example by eliminating quantitative restrictions (quotas). The WTO regulates international trade relations on the basis of three general principles: the rule of non-discrimination or reciprocity (concessions to one country must be given to all other WTO members); the rule of the most favoured nation (imported goods from member countries should be treated on an equal footing with domestically produced goods); prohibition of quantitative restrictions, that is protection for domestic industry should be made through the use of tariff rather than non-tariff barriers (Conceição-Heldt 2011a). Regional co-operation, for example in the EEC set up in 1957, was accepted since it helped eliminate protectionism.

The EU accounts for 17% of global trade, is the largest exporter and second largest importer of goods and a major player in WTO negotiations (World Trade Organization 2009). In the 2000s, the fast growth of large emerging economies such as India, China and Brazil reduced EU’s market power. Binding EC tariff reductions have decreased the scope for the EU to withdraw market access. The main leverage that remains in terms of market access is the agricultural sector. However, the EU has a very defensive position on this sector due to its highly subsidized agricultural products in the framework of the common agricultural policy (CAP). The CAP protects European farmers from international competition through import tariffs, domestic support subsidies and export subsidies. One of the main criticisms made of the CAP is that the large subsidies paid every year to European farmers hinder trade liberalization and the economic development of developing countries. The EU reacted to this criticism in 2001 by giving LDCs preferential treatment by granting them 97% duty-free access without any quantitative restrictions to imports of all products, except arms and ammunitions, with the so-called ‘Everything but Arms’ initiative. Moreover, at the Hong Kong WTO ministerial meeting in 2005, the EU also agreed to abolish all export subsidies by 2013. However, since the Doha Round is deadlocked and WTO members agreed on the ‘single undertaking principle’ (nothing is agreed until everything is agreed), this concession will not take effect if there is no progress on the other issues that are on the negotiating agenda of the current round of trade talks (Conceição-Heldt 2012, 164).
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Negotiations on agricultural issues included sharp reductions in high farm tariffs (market access), the elimination of export subsidies and substantial cuts in domestic subsidies in different categories. The EU would not consider reducing tariff rates unless geographical indications for European products are taken into account so that a large number of agricultural products would be automatically excluded from liberalization. Moreover, the EU asked for less transparent forms of export support (such as export credits, state trading enterprises and food aid) to be included under the category of export subsidies (European Commission 1999). At the same time, the EU wanted to keep the system of domestic support covered by the blue and green boxes (blue: direct payments that compensate farmers for income loss when production is reduced, and green: subsidies that have no impact on production, such as set-aside programmes). Finally, the EU asked for the inclusion of the controversial principle of multifunctionality in the negotiating agenda. This refers to the non-trade objectives of agriculture, such as environmental protection, food security and rural development. This was opposed by other WTO members, especially by those with an interest in increasing their agricultural exports (such as the USA, Brazil or Australia), and was controversially discussed during the Doha Round. These countries considered the multifunctionality principle a ruse that would to allow the EU to protect its agricultural sector (Conceição-Heldt 2011a, 126).

While the EU has an offensive position on trade liberalization for the industrial and services sectors, it continues to stick to a very defensive and protectionist position on agricultural trade issues. Despite the strong decline of agriculture in terms of employment and output in industrialized countries, agricultural protectionism remains one of the most contentious issues in current trade talks in the WTO (Conceição-Heldt 2011a). The EU’s negotiating position at the multilateral level can be explained by looking to interstate bargaining at the Council of Ministers and demands put forward by interest groups. Before being able to speak with a single voice (Meunier 2000), member states have to find a common position in order to give the European Commission a negotiating mandate on all trade issues. The preferences of EU member states on trade liberalization depend on the main economic interests that states have in relation to the different issues dealt with in trade negotiations. For some member states, trade liberalization in industry (e.g. Germany) and the financial sector (e.g. UK) are central concerns, while other member states are more focused on the impact of agricultural trade liberalization on their farmers (e.g. France) (Conceição-Heldt 2011b). As Moravcsik (1993, 1997) puts it, national government preferences are a function of pressures from those interest groups that mobilize against policy change because they stand to lose from trade liberalization. Farmer organizations remain the greatest opponents of further agricultural trade liberalization. They argue that reduction in subsidies would undermine the European multifunctional model of agriculture and force farmers to abandon agricultural activity en masse. France and Ireland would be the main losers. Accordingly, they oppose further agricultural concessions in the Doha Round. National farmer federations continue to successfully lobby at the European and national levels. The inclusion of the principle of multifunctionality was a demand put forward by the leading agricultural confederations at the European level, the Committee of Professional Agricultural Organizations (COPA) and the General Confederation of Agricultural Cooperatives (COGEC), which represent the interests of large agricultural producers. By contrast, the European business sector, represented in the peak confederation Business Europe, asked for better market access for industrial products, services liberalization and better WTO rules against anti-dumping. The EU’s negotiating position asking for the inclusion of Singapore issues in the negotiating reflected the demands of the business sector (Conceição-Heldt 2011a, 132–33). Thus the EU’s paradigm of ‘agriculture exceptionalism’ is a function of policy preferences of member states with defensive (agricultural sector) and offensive (industry,
services and finances sectors) positions and domestic and European interest groups. These preferences are aggregated in the interstate and interinstitutional bargaining and translated into a common position. Thereby, the challenge for the European Commission is to achieve a balance between the different policy positions in order to avoid involuntary defection at the ratification stage.

Negotiations on multilateral trade liberalization have been protracted, and a number of WTO ministerial meetings have ended in deadlock. But several attempts to resume negotiations have failed, especially because major trading nations did not move from their initial negotiating positions on the controversial agricultural sector (Conceição-Heldt 2011a). Some authors (Schott 2004; Young and Peterson 2006) argue that the Doha Round is deadlocked because the nature of international trade politics has changed since the 1980s owing to two major developments. First, the scope of multilateral trade negotiations has been extended to new issue areas, such as agriculture, textiles, services, investment and intellectual property rights. Second, the rise of emerging powers, such as China, India and Brazil has challenged the positions of developed countries in multilateral trade negotiations (Hurrell and Narlikar 2006; Narlikar 2010). For example, in 2003 Brazil created a new coalition group (the G-20) within the WTO to represent the interests of emerging and developing countries (Narlikar and Tussie 2004). This group of countries favours extensive agricultural liberalization and opposes export and domestic support subsidies (Conceição-Heldt 2011a, 10). The building of these new coalitions within the global trade regime poses a challenge for the USA and the EU since emerging powers are not willing to open their markets for industrial products without having considerable concessions in classical protectionist sectors (e.g. textiles, clothing, footwear, iron, steel, consumer electronics and agriculture) that are important for their domestic constituencies.

After the collapse of negotiations in 2006, major players declared they would move towards PTAs. The USA had the best fall-back position because it had already started negotiations on several PTAs in 2003 and 2004 and was now negotiating new ones (Heydon and Woolcock 2009). For the Obama Administration trade policy is low on its list of priorities. The President’s approach to trade policy is defensive with an emphasis on better enforcement of trade laws to ensure foreign access for US exports (Erixon 2010). The EU is also in a defensive mode and shifted its trade strategy towards bilateral and regional preferential trade agreements with the publication of Global Europe: Competing in the World in 2006 (Sbragia 2010). Although the EU is now negotiating several PTAs, with the exception of the PTA with South Korea, trade negotiations are stuck. That is the case with ASEAN, Mercosur and bilateral negotiations with India, China, Russia and Canada (Dür 2010, 188; European Commission: Directorate-General Trade 2011b).

**EU shift towards regionalism and the negotiations with Mercosur**

We have seen a revival of regionalism world-wide over the past two decades. This new wave of regionalism is not confined to narrow geographic areas coinciding with PTAs. According to Hoekman and Kostecki (2001) regional trade agreements have been fostered by two factors. First, there was a shift in the USA towards regionalism in the 1980s with the negotiation of the North America Free Trade Agreement (NAFTA), driven in part by frustration with slow negotiations at the multilateral level. Second, as major trading nations created regional trade blocs, the pressure on others to follow suit increased due to the high costs of staying apart, provoking a domino effect or ‘domino regionalism’ (Baldwin 1995).

There is now a broad discussion on whether regional trade agreements facilitate or obstruct multilateral trade negotiations, whether they are stepping stones or stumbling blocks (Baldwin...
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2006b; Bhagwati 1992; Lamy 2002). For big trade powers, such as the EU or the USA, preferential agreements have the advantage of enabling larger countries with a big internal market (Drezner 2007) to impose their conditions on smaller parties and to exempt sensitive sectors from liberalization (Ravenhill 2011). A list of products to be excluded also improves the chances of signing a PTA because it makes it more palatable in political terms (Grossman and Helpman 2002; Vaillant and Ons 2002).

In the early 1990s, the USA adopted a trade strategy of ‘open regionalism’ (the pursuit of trade agreements compatible with multilateralism as they do not formally discriminate against third parties) by emphasizing deeper integration among the parties (Grugel 2004). One of the first steps in this direction was the creation of NAFTA in 1994 (Destler 2005). The EU reacted to NAFTA by starting bilateral trade negotiations with Mexico in 1996. At the same time, the EU pursued a strategy of bilateralism and regionalism towards other regions such as the Caribbean and the Mediterranean. As early as 1996, the European Commission declared that bilateralism and regionalism would be key tools in developing a market access strategy for European firms and investors and increasing the EU’s competitiveness (Leal-Arcas 2008).

The political interest of the EU in strengthening diplomatic and trade relations with Latin American countries arose from the need to counter American hegemony in this region (Aggarwal and Fogarty 2004; Sbragia 2010). In addition, pressure from European exporters fearing major losses of market share in Mexico played a major role in the EU paradigm shift for this region (Aggarwal and Fogarty 2004; Dür 2007). From the Mercosur point of view, negotiations with the EU are part of a long-term strategy to diversify trade in general and to signal to the USA that the FTAA is not the only game in town (Grugel 2004).

For the EU, a strategic partnership with Latin America goes beyond questions of economic governance, covering a wide range of social and development issues (European Union External Action 2012). The signature of the EU-Mercosur interregional cooperation agreement in December 1995 illustrates the social and normative power of the EU in setting standards, creating norms and values (Van Ham 2010). The agreement includes aspects such as good governance principles, social responsibility, elite interaction and EU-sponsored seminars (Agence Europe 1995).

The EU–Mercosur global cooperation agreement came into force on 1 July 1999 and provided the basis for negotiations to establish a free trade area between the two blocs (Vaillant and Ons 2002). From the very beginning, EU member states were divided on the timetable and on the type of trade agreement with Mercosur. France, Ireland and the UK were against a free trade area, preferring to wait for the conclusion of WTO multilateral negotiations before committing themselves to further trade agreements. France and Ireland opposed inclusion of the agricultural sector in the trade agreement due to its impact on their farm sector. In turn, Portugal, Spain and the Benelux and Scandinavian countries supported a free trade area with Mercosur and wanted to start negotiations as soon as possible. By contrast, Mercosur opposed exclusion of the agricultural sector from the agreement and pleaded, as in the WTO negotiations, to use the single undertaking principle. In the end, EU member states agreed on giving the European Commission a mandate to negotiate a free trade agreement, not a free trade area, with Mercosur to attain progressive and reciprocal liberalization in all trade sectors. At the same time, negotiations on non-tariff barriers (a catch-all phase that included any barriers to international trade other than tariff rates) were to start immediately and negotiations on tariff rate reductions and services were to start in July 2001. Mercosur negotiations were to be concluded after the negotiations of the WTO round and take account of the results and timetable set for the free trade area of the Americas (FTAA) between all the countries of the American continent headed by the USA, which were expected to be concluded by 2005 (Agence Europe 1999b).
The main impetus for negotiating a PTA with Mercosur was the competition with the USA for access to Latin American markets. The European Commission had even prepared a memorandum that calculated the market share that the EU could lose following the FTAA. The memorandum showed that US exports to Mexico rose from US $41,000m. in 1994 to $79,000m. in 1998 after the entry into force of NAFTA, while the EU share in Mexican trade had declined considerably to €49,000m. The EU accounts for around 50% of Mercosur's imports and exports, while Mercosur accounted for only 3% of EU exports and imports. Agriculture and fisheries represent almost 36% of Mercosur exports to the EU, and almost 18% of Brazilian, Argentinean, Uruguayan, and Paraguayan exports involve 'sensitive' European agricultural products. Whereas the EU's priority was to increase trade exports in the industrial sector such as automobiles, machinery and transport equipment, services, banking, shipping and telecommunications, Mercosur asked for the dismantlement of agricultural subsidies (Agence Europe 1999c). Brazil is not only the leader in South America and Mercosur, but also its largest economy, accounting for 70% of total Mercosur gross domestic product (GDP) (Grugel 2004). Brazil has meanwhile become the world's third largest exporter of agricultural products; the agribusiness sector (commodity and processed goods) is one of the most dynamic sectors of the Brazilian economy, accounting for over 30% of all exports and 35% of all jobs (Conceição-Heldt 2013). Agricultural trade liberalization is thus the key sector for Brazil and Latin America.

EU–Mercosur negotiations began officially on 6 April 2000. After several meetings in 2005 and 2010, negotiations have been deadlocked since then because the EU wants to have further liberalization for the industry and services sectors, while Mercosur countries demanded lower customs duties for their agricultural products (Agence Europe 2005). In a letter to the Commission, EU peak agricultural organization COPA-COGECA voiced its opposition to a relaunch of negotiations because of the impact of the trade agreement on the European meat (bovine, pork and poultry) and fruit sectors (citrus, oranges and juices). They estimated that opening the market in these two sectors would jeopardize 28m. jobs and that Mercosur products did not comply with the multifunctionality principle and the high EU producer standards in the fields of food safety, animal welfare and the environment (Agence Europe 2010).

For Mercosur countries, the main gains from trade liberalization are concentrated in agriculture (Argentina, Brazil and Uruguay), raw materials of agricultural origin (Paraguay) and manufacturing industries (Brazil and Uruguay). Brazil, in particular, opposes any further opening of Mercosur markets if the EU does not offer significant concessions in terms of greater market access to Mercosur agricultural products. Since opening the agricultural sector to Argentina and Brazil would have a huge impact on the European farming sector, especially in France and Ireland, the EU rejects reciprocal trade liberalization in the sector that really matters for Mercosur. As Mattli (1999, 65) points out, there are two crucial conditions for successful intra-bloc liberalization. First, trade liberalization is more likely when the potential economic gains from a PTA are high. Second, hegemonic leadership for the bloc as a whole increases the likelihood of liberalization. However, the specific case of EU–Mercosur shows that, even when the potential gains are high for both sides, when one party (EU) refuses to make major concessions on one major sector in the negotiations, liberalization is less likely.

**Shift towards bilateralism: the use of political conditionality in the EU–Mexico PTA**

The EU–Mexico FTA is part of the wider ‘Economic Partnership, Political Coordination, and Cooperation Agreement between the European Union and Mexico’ (Szymanski and Smith
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2005). The agreement is made up of three pillars: political dialogue, trade liberalization and cooperation. While Mexico’s main objective was to secure an FTA, the EU was more concerned with the political and cooperation dimensions (Szymanski and Smith 2005, 177). The inclusion of a democracy and human rights clause enables the agreement to be suspended if one party does not fulfil its obligations (Agence Europe 1998). Political conditionality was one of the most contentious issues during negotiations and reinforced the image of the EU as a normative power (Manners 2002).

Conditionality encompasses political and economic aspects, internal and external supervision, and positive and negative sanctions. Whereas political conditionality links rewards with expectations and the execution of policy in third countries that promote democracy, human rights and good governance, economic conditionality links rewards with the adoption and promotion of specific microeconomic policies, such as structural adjustment programmes (Holland 2002). The underlying rationale for the use of political and economic conditionality by the EU in negotiating PTAs is three-fold. First, the EU exports its own policies and regulatory standards to gather bargaining power vis-à-vis the USA at the multilateral level (Baldwin 2002). Second, the export of its own regulatory standards allows the EU to strengthen the international competitiveness of its firms. Finally, the EU intends to stabilize neighbouring countries and encourage regional stability through trade agreements (Maur 2005). This last aspect is irrelevant for the EU–Mexico trade agreement.

Mexico is a minor trading partner of the EU. It was only after the entry into force of NAFTA that Mexico became an interesting trading partner for the EU (Dür 2007, 837). Whereas for Mexico the PTA with the EU was part of a trade diversification strategy to reduce its dependence on the USA, for the EU the PTA with Mexico was a way to gain better access to the preferential trading area created by NAFTA (Busse et al. 2000, 7).

In 1996, Spain had prepared a memorandum outlining why a PTA with Mexico was important for the EU. First of all, with the entry into force of NAFTA, European companies were expected to lose market share to the USA and Canada, and by 2003 90% of EU exports would have been affected by NAFTA provisions. This is in line with Dür’s (2007) protection for exporters argument. Second, Mexico might introduce higher customs duties than those in force at that time (10%). Third, Mexico was the EU’s principal trading partner in Latin America, absorbing 24% of total EU exports to the region. The two main beneficiaries of a free-trade area with Mexico would be Spain and France. Whereas Spain would be able to export meat products and aeronautical equipment, France could increase exports of textiles and rail equipment (Agence Europe 1996a).

As in the negotiations with Mercosur, there was little agreement among member states on the scope of the partnership. Whereas Spain, Sweden and the UK wanted to establish a free trade area, this was opposed by Denmark, France, the Netherlands and Portugal (Agence Europe 1996b). As a result, the Council directives allowing the European Commission to negotiate a new agreement with Mexico made no reference to a ‘free trade area’, but rather to ‘mutual and progressive liberalization of the trade in goods, services, and investment’ (Agence Europe 1996c). One of the major points of contention during negotiations was the length of the transitional period until complete liberalization for industrial goods. The EU asked for complete liberalization in 2003, while Mexico requested a 10-year transition period. Finally, the EU and Mexico agreed that by 2007 European goods would enjoy full duty-free access to the Mexican market: 47% of trade for manufactured products would be liberalized immediately, 53% in 2003, 60% in 2005 and the rest in 2007. By July 2000 Mexico would have free access to Europe for 82% of its manufactured products (Agence Europe 1999a).

The inclusion of the democracy clause was the second contentious issue. In early 1994, the Mexican government had reacted to the Zapatista uprising in the state of Chiapas by expelling
foreign observers (Szymanski and Smith 2005, 180–81). In 1996, the EU intended to finance an NGO through the Mexican Academy of Human Rights project for the protection of human rights and to control electoral spending by candidates to the forthcoming legislative elections. This was opposed by the Mexican government, which considered this funding to be interference in internal electoral procedures and reacted by blocking the EU donation to the Mexican Academy of Human Rights. This led to a virulent reaction by the European Parliament, which criticized the weakness of the European Commission and invited representatives of Mexican NGOs and victims of human rights abuses to testify before parliamentary committees (Agence Europe 1997).

In the end phase of negotiations, Mexico asked for deletion of the term ‘domestic and external policies’ from the democracy clause. Belgium and France threatened to veto the agreement if this reference was deleted. They argued that the democracy clause had to be consistent for all EU cooperation agreements with third countries. The EU had just cancelled negotiations for a new trade agreement with Australia on the grounds that it had refused to include this clause. Finally, the Mexican government simply agreed to its inclusion in the democracy clause (Szymanski and Smith 2005, 184–85). According to Szymanski and Smith (2005, 185–86), the Mexican government changed its position first because it wanted to show more respect for human rights and in the fight against corruption. Second, the EU negotiators persuasively argued that the democracy clause was a key element of a partnership between equal partners rather than an instrument of coercion by a stronger power. Third, the European Commission could credibly use the paradox of internal weakness argument since member states had threatened non-ratification of the agreement if the wording of the democracy clause was altered. The Commission thus effectively used a form of ‘rhetorical action’ and norm-based arguments (Schimmelfennig 2001) to achieve its preferred outcome.

**Conclusion**

Over the past 10 years, the EU has gradually changed and adapted its trade policy by joining the ‘race to the bottom’ for unilateral trade liberalization. The EU’s paradigm shift to bilateralism and regionalism was also stimulated by competition with the USA for markets and investment. Officially, from 1996 to 2006 the EU embraced a new trade policy doctrine of managed globalization that consisted basically in showing its commitment to multilateralism by adopting a ‘moratorium’ on the negotiation of any new trade agreements, while pursuing ongoing negotiations at the bilateral and regional levels. As WTO negotiations were temporarily suspended in 2006, the EU definitively shifted its trade policy towards regionalism and bilateralism. In the meantime, the EU has concluded several bilateral trade agreements with Chile, South Africa, Mexico and South Korea and is negotiating PTAs with China, India and Mercosur. This shift in the EU trade approach poses a challenge for the efficacy and legitimacy of the global trade regime. First, the proliferation and complex web of trade arrangements creates a ‘spaghetti bowl’ of overlapping trade rules that erode the WTO principle of non-discrimination or reciprocity and thus weakens multilateral trade rules. Second, the negotiation of PTAs draws negotiating capacity away from multilateral negotiations.

What is new is that the EU goes beyond economic governance by using its social or normative power in order to promote certain common values and norms. This includes conditions such as political dialogue, democracy, human rights, and social and development issues. For example, when negotiating with Mexico, the EU was able to use its asymmetrical bargaining power by imposing its conditions (the inclusion of a democracy clause) on a smaller and weaker party. By contrast, when negotiating with an equal bargaining party, the Mercosur under
Brazilian leadership, the EU was not able to impose its rules and conditions. While EU–Mercosur negotiations continue with a conclusion not yet in sight, the EU–Mexico PTA was successfully concluded in July 2000.

At the multilateral level, the EU asked for the inclusion of the controversial principle of multifunctionality in agriculture. This demand was perceived by the other trading partners at the WTO level as a new protectionist mechanism for the European agricultural sector and was one of the most controversial issues dealt with in the current deadlocked Doha Round. The EU’s role at the multilateral, regional and bilateral levels when negotiating trade agreements shows how the EU uses its material and social power to obtain concessions from the other bargaining parties.

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Eugénia da Conceição-Heldt


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Global economic governance

Intellectual property

Susan K. Sell

Intellectual property is one of the most dynamic and volatile areas of global economic governance. What at one time appeared to be an arcane and forbiddingly technical area of regulation has animated many bitter disputes and political protests. Public health activists have argued that patent rights present a barrier for access to essential medicines; advocates for free speech and privacy protest against draconian measures to regulate the internet. Forum proliferation and inconsistent mandates across diverse forums have complicated the institutional landscape. Multiple stakeholders have engaged in the practices of both horizontal (from one multilateral venue to another) and vertical (from multilateral to plurilateral, regional or bilateral) forum-shifting in order to secure strategic advantage for their preferred outcomes. Non-state actors always have played an important role in intellectual property policy, although states remain important as both the granters and guarantors of intellectual property rights. This chapter examines the evolution of international intellectual property policies, with a focus on the institutional and political contestation, players, paradigms and power.

Over time power has shifted from a dominant USA toward rising powers such as China, Brazil and India. With their economic rise and the financial crisis of 2008 these countries have gained more political clout; they are important players. The circle of stakeholders has also expanded, from private sector rights holders and their trade ministries to public health advocates and crusaders for internet freedom. Rather than strictly closed-door, top-down policymaking, recent developments point to an unintended opening of the process that suggest a more bottom-up, broad-based engagement with the issues. Whether or not this change is sustainable remains to be seen. The paradigms that animated the Agreement on Trade-Related Aspects of Intellectual Property (TRIPs) are shifting from a belief that more property rights are better to a deeper questioning of the costs of overly strong property rights and the lack of balance between rights holders’ rights, on the one hand, and obligations on the other. Part I examines the institutional proliferation and evolution of governance of intellectual property. Part II presents the contestation over intellectual property and public health. Part III discusses the tactic of vertical forum-shifting and the turning away from multilateral venues. Finally, Part IV examines the implications of these changes for global economic governance of intellectual property.
In recent years regulatory institutions have proliferated across the world (Moschella and Weaver 2013). In the late 19th century, an earlier era of globalization, states negotiated two conventions in order to facilitate trade in intellectual property-protected goods and services: the Paris Convention for the Protection of Industrial Property (1883) and the Berne Convention for the Protection of Literary and Artistic Works (1886). The Paris Convention covered patents and industrial designs, whereas the Berne Convention covered copyrights. These Conventions were voluntary and non-binding and institutionalized national treatment. Signatories pledged not to discriminate against foreign-held intellectual property. These Conventions provided ample room for states to design policies crafted for their particular developmental needs and facilitated commerce in intellectual property-protected goods.

In 1893 the International Bureaus administering the Paris and Berne Conventions merged and became the United International Bureaux for the Protection of Intellectual Property (BIRPI). In 1967 it became the World Intellectual Property Organization (WIPO) and its mandate became promoting the protection of intellectual property world-wide. When WIPO became a specialized United Nations agency in 1974, its mandate broadened to include the encouragement of technology transfer to developing countries. This reflected the concerns of the developing country UN membership that was engaged in promoting a New International Economic Order (NIEO) that would transfer resources from North to South (Sell 1998). As a part of the NIEO, WIPO members engaged in negotiations to revise the Paris Convention to better reflect the needs of developing countries. Developing countries sought laxer intellectual property protection, special treatment, substantial technology transfers and stronger rights to issue compulsory licences (under which the state licenses the foreign technology for domestic production).

Meanwhile the USA was facing profound economic change with many of the so-called ‘rust belt’ sectors, such as steel and shipbuilding, experiencing decline due to heightened foreign competition. The rising US industries during the 1970s included computer software, agricultural chemical, pharmaceuticals and entertainment products (movies and music). The scope of goods and services eligible for intellectual property protection dramatically expanded, and included computer software and living organisms. These industries began to complain that foreign countries were not respecting their intellectual property rights and that the government needed to take action.

These private sector actors began to define intellectual property as a trade issue and argued that they were losing trade revenue due to inadequate global protection of their intellectual property. The US government responded to their requests and Congress adopted a number of trade laws and policies intended to strengthen these firms’ competitive positions abroad. The Office of the United States Trade Representative (USTR) began working with private sector rights holders and led bilateral consultations with countries that the firms had identified as inadequately protecting their intellectual property.

In Geneva, the multilateral Paris Convention negotiations proceeded from 1979 and ended in a deadlock by 1985. US rights holders, beginning to achieve their desired results through bilateral pressure on countries such as South Korea and Taiwan, rejected efforts to weaken intellectual property protection in the Paris Convention. They decided to continue their bilateral efforts and endeavoured to pursue a trade-based approach multilaterally. The 1980s debt crisis engulfed developing countries. Desperate to attract foreign investment, rather than to regulate it as the NIEO had called for, they gave up on the NIEO and focused on trying to get their economies back on track. They began to implement the World Bank’s structural
adjustment policies and the ‘Washington Consensus’ as the International Monetary Fund promoted it. They engaged in economic liberalization, privatization of state-led enterprises and sharp reductions in government spending.

USA-based pharmaceutical, software, agricultural chemical and entertainment multinational corporations continued to press both the Executive branch (USTR) and Congress to strengthen trade-based approaches to intellectual property protection. Congress passed the Trade and Tariff Act of 1984; its Section 301 allows petitioners to ask the USTR to impose trade sanctions on trading partners whose practices harm US industry. The chief executive officers of International Business Machines, John Opel, and Pfizer Pharmaceutical, Edmund Pratt, worked together to press for stronger intellectual property protection abroad.

Opel and Pratt had been frustrated by the Paris Convention Negotiations and by 1985 moved from just trying to block developing countries’ demands for weaker protections to finding a way to obtain much stronger protection abroad. In 1985 IBM commissioned an economist, Jacques Gorlin, to draft a paper developing the contours of a trade-based multilateral intellectual property agreement. This became the basis of the strategy that the firms pursued. A trade-based approach would allow the USA to use its market access as leverage to achieve the private sector’s goals. The US Government, pressed by its rights holders, sought to embed its Section 301 approach into the multilateral system. Gorlin established the Intellectual Property Committee (IPC) in March 1986; the IPC included Bristol-Myers, DuPont, FMC Corporation, General Electric, Hewlett-Packard, IBM, Johnson & Johnson, Merck, Monsanto, Pfizer, Rockwell International and Warner Communications (Drahos and Braithwaite 2000). These private sector actors urged the USTR to press for a multilateral trade-based intellectual property agreement.

The General Agreement on Trade and Tariffs (GATT) Uruguay Round of trade negotiations began in 1986, and the IPC reached out to private sector trade associations in Japan and Europe to build strong private sector support for a trade-based intellectual property agreement. The IPC and its European and Japanese counterparts drafted a ‘tri-lateral’ proposal for a multilateral trade-based intellectual property agreement; a substantial portion of this proposal was adopted in TRIPs.

A small cadre of private sector actors, working with a supportive USTR and the backing of the US Government, wrote public law for the world. This horizontal forum shift, from WIPO to GATT/the World Trade Organization (WTO), initiated the multilateral forum proliferation in intellectual property. With the establishment of the WTO and its enforcement capacity, these private actors got much of what they wanted. Now all WTO members had to implement strong intellectual property laws, including patent protection for pharmaceutical products (that few countries had before TRIPs).

Developing countries were not enthusiastic about TRIPs, but assented as a quid pro quo in which they were promised expanded market access for their textiles and agricultural goods in exchange for their offering strong intellectual property protection. Furthermore, many countries that the USA had targeted under Section 301 believed that having a rules-based multilateral agreement would end the bilateral economic coercion. Industrialized countries and their rights holders saw TRIPs as a floor (a bare minimum standard); developing countries saw it as a ceiling (the highest level of protection they could agree to). Non-consensual perspectives have driven a continuing process of forum proliferation, forum-shifting and contestation.

Private sector intellectual property-exporting interests, backed by powerful states with strong economies, ample market leverage and profoundly asymmetrical bargaining power achieved TRIPs. It never looked like a great deal for developing countries, but it was one they were willing to accept in exchange for expanded market access in goods for which they held...
comparative advantages. TRIPs never reflected a robust multilateral substantive consensus; it did not take long for controversies to surface.

**Contestation: intellectual property and public health**

In the late 1990s an HIV/AIDS pandemic swept through sub-Saharan Africa. The only hope of saving millions of lives was to obtain anti-retroviral (ARV) drugs. These patented drugs were unaffordable. South Africa’s Treatment Access Campaign demanded ARVs and mobilized in support of the 1997 Medicines Act. The Act would have allowed Nelson Mandela’s Government to engage in parallel importation to secure access to less costly patented medicines from other markets. Thirty-nine USA-based pharmaceutical companies sued Nelson Mandela and claimed that the Medicines Act violated their intellectual property rights. This lawsuit generated a pharmaceutical industry public relations disaster of gargantuan proportions.

Brazil also had a significant HIV/AIDS-affected population and had adopted an aggressive plan of publicly guaranteed ARV treatment. Brazil had generic drug production capabilities and negotiated steep price discounts with brand name drug firms by threatening to compulsory license the products it needed. India had developed a robust generic pharmaceutical industry by patenting only processes, not products, so that its drug producers could produce generic versions of patented drugs.

With Brazil’s demand, and India’s generic competition, the prices of bulk chemicals for producing ARVs dropped dramatically. Between 2000 and 2001 generic ARV prices dropped from $10,439 per patient per year to $295, or less than a dollar a day (Avert 2011). Consumer groups, public health activists, HIV/AIDS patient advocacy groups and non-governmental organizations, such as Doctors Without Borders and Health Action International, framed intellectual property as a public health issue. They argued that patent protection led to high prices, inaccessibility and, therefore, unnecessary deaths.

African governments, Brazil, non-governmental organizations (NGOs) and legal experts worked together and raised their concerns about access to medicines in the World Health Organization (WHO). This was an important horizontal forum shift because it allowed them to recast intellectual property in different terms. There, health advocates worked on an access to essential medicines programs in which the WHO produced a list of drugs that all public health programs should stock and provide. WHO prioritized access and supported compulsory licensing against the brand name pharmaceutical firms’ interests. In 1999, the World Health Assembly of the WHO unanimously agreed to this approach.

Controversies between rights holders, patient groups and governments continued to flare. The USTR kept placing countries facing the HIV/AIDS crisis on its Section 301 Watch Lists, its naming and shaming mechanism under US trade law. Brand name pharmaceutical firms complained that countries using TRIPs’ flexibilities to increase access to medicines (such as parallel importing and compulsory licensing) were violating TRIPs. Finally, in November 2001 during the Doha Round of trade negotiations, WTO members agreed to the ‘Doha Declaration on TRIPs and Public Health’ to clarify that nothing in TRIPs should prevent governments from providing public health. While the Declaration did not represent any substantive change, it was a rhetorical gambit to highlight the importance of public health (patients before profits). It also represented another horizontal forum shift from the WHO, where the World Health Assembly had endorsed the access to medicines norm, back to the WTO in this formal Declaration.

WIPO, WTO, and WHO all have intellectual property portfolios as a result of various global governors exercising agency and using institutions as strategic resources to underscore particular
value commitments—property rights, trade and public health, respectively. However, since rights holders have continued to expand intellectual property rights to cover biodiversity, genetic material, germplasm and seeds, even more forums have gained intellectual property portfolios, adding to forum proliferation. For example, the Convention on Biological Diversity includes provisions that aim to curb ‘biopiracy’, a practice in which pharmaceutical or agricultural firms take biological material out of bio diverse countries without compensation and then produce profitable patented goods incorporating this material. The Convention on Biological Diversity requires prior informed consent and access and benefit-sharing provisions. Similarly, the Food and Agriculture Organization, the United Nations Educational, Scientific and Cultural Organization and the Office of the High Commissioner for Human Rights all have intellectual property portfolios that embody a more development-friendly vision of intellectual property rights than that enshrined in the WTO. Contestation between paradigms governing intellectual property protection drives both forum proliferation and forum-shifting. Contested paradigms had already surfaced in the failed Paris Convention revision negotiations during the NIEO era.

Developing countries remain frustrated that the developed countries have not made good on their Uruguay Round promises for expanded agricultural market access. In the deadlocked Doha Round of trade negotiations that began in 2001, developing country negotiators resisted many of the new issues that the OECD wanted to push (such as competition policy and government procurement) because they had yet to be granted the agricultural market access that they were promised. OECD governments and their rights holders’ firms have continued to press for higher standards of intellectual property protection and enforcement since TRIPs through bilateral and plurilateral channels. US Free Trade Agreements and European Economic Partnership Agreements invariably include protection and enforcement requirements that exceed those in TRIPs. The OECD-based intellectual property rights holders had always seen TRIPs as a floor, or minimum standard of protection, and continued to seek ways to raise the standards of protection and enforcement. In 2001 everyone in the WTO was focused on the access to medicines issue. The rights holders’ coalition knew that it could not press for TRIPs-Plus standards in the WTO.

Rights holders and their governments went back to the World Intellectual Property Organization (WIPO) in search of a more receptive forum. There they sought to resuscitate the Substantive Patent Law Harmonization Treaty negotiations. However, the medicines issue had galvanized developing countries and their NGO supporters; they quickly understood that the rights holders were seeking a TRIPs-Plus multilateral agreement at WIPO. Developing countries refused to discuss harmonization until the rights holders’ coalition would agree to discuss intellectual property and development. In many ways this was reminiscent of the NIEO Paris Convention positions and underscored that the ‘thin state consensus’ of multilateral treaty-making must never be mistaken for a robust ‘thick stakeholder consensus’ (Pauwelyn et al. 2012).

Vertical forum-shifting

WIPO members began negotiations on a Development Agenda while the USA warned WIPO not to press too far. Negotiators finally adopted a Development Agenda for WIPO in 2007 and, two short weeks later, the USA, the European Community and Japan shifted forums vertically. They announced that they would be negotiating an Anti-Counterfeiting Trade Agreement (ACTA) with a select group of like-minded states. They knew that they could never get their preferred agreement in the multilateral WIPO. As Benvenisti and Downs point out, powerful
states engage in vertical forum-shifting when their ‘vital interests are at stake and where their position on issues is far different from those of the vast majority of states’ (2007, 611).

The Anti-Counterfeiting Trade Agreement (ACTA) is designed to address internet practices of file-sharing and at-the-border enforcement measures. ACTA also seeks to curb trademark-counterfeiting and copyright piracy, and to engage customs authorities more fully in stopping the flow of infringing goods. The scale of what constitutes infringement is unclear in the text. Many fear that uses granted under Fair Use provisions in US copyright law (e.g. for strictly personal or educational uses) would be targeted under this vague language. ACTA sets up a separate free standing institution and its relationship to other intellectual property institutions (WIPO, WTO) remains unclear. ACTA generated controversy early on, as it was being negotiated in asymmetrical secrecy. Rights holders had access to negotiating texts, but the public was completely shut out of the process. USTR rejected numerous Freedom of Information Act requests for text based on ‘national security’ grounds (Levine 2012). When leaked text chapters became available on WikiLeaks, NGOs, internet users and European Parliamentarians became alarmed at the TRIPs-Plus provisions. To many it looked like an over-reaching, draconian agreement. ACTA’s critics raised issues of censorship, free speech and threats to the internet.

The US Government went forward with the non-transparent negotiations that were driven by the copyright content industries (motion picture, music and software), and signed the agreement in 2010. Simultaneously, the Motion Picture Association of America, the Recording Industry Association of America and companies like EMI, Disney and Time Warner were pressing for domestic legislation to update copyright for the digital age. They expected smooth legislative sailing owing to their unbroken track record in achieving ever higher standards of intellectual property protection over the previous 30 years. The cosy relationship between Congress and copyright content industries is long-standing and well known (Litman 2006). Indeed, former Senator Christopher Dodd now heads the Motion Picture Association of America that presses for expanded copyright protection and enforcement. The two proposed laws were the Stop Online Piracy Act (SOPA) in the House and the Protect Intellectual Property Act (PIPA) in the Senate. SOPA was introduced in the House of Representatives in September 2011.

SOPA targeted foreign pirate websites that host copyright-infringing content. SOPA was to block US internet users’ access to such sites and block online payment-processing services such as PayPal from transferring money to the sites. In contrast to ACTA, policymakers deliberated SOPA transparently in the US House of Representatives. Internet users and founders of sites featuring user-generated content, such as Reddit and I Can Has Cheezburger, mobilized quickly to protest against the bill. Open internet champions Aaron Swartz and Alex Ohanian (co-founders of Reddit) made extensive use of Web 2.0 interactive technologies to notify internet users and the technology community of the dangers that the bill posed to internet freedom, privacy and free speech. They framed their mobilizing campaign around ‘stop censorship’ and posted information and online petitions, and organized boycotts against the bill’s supporters (such as the website host Go.Daddy.com).

The anti-SOPA coalition worked with blogs (e.g. Boingboing and Tech Dirt), government partners, European Pirate Parties, the European Parliament, European Green Parties, US domestic NGOs (such as Electronic Frontier Foundation and Public Knowledge), foreign NGOs (such as France’s La Quadrature du Net) and a handful of US Congress members (Ron Wyden, Darrell Isa, Zoe Loigren, Jason Caftetz and Jared Polis) to stop the bill. Google posted an online petition that gathered millions of signatures. Posted links to Congress persons’ phone lines generated hundreds of thousands of calls, jamming switchboards. The hacktivist group Anonymous even got involved posting embarrassing information about some of the bill’s supporters.
Jimmy Wales, Wikipedia’s founder, used his ‘talk page’ to solicit community members’ opinions on whether to black out the site to protest against the anti-piracy bills. The community responded with a resounding ‘yes’ (Sell 2013). On Wednesday, 18 January 2012 over 15,000 websites went dark for 24 hours, including Wikipedia, Mozilla and Reddit, to protest against the legislation and underscore the consequences if the bill was passed. Millions of users got the message; Google and Craigslist featured censor bars on their home pages. Before the web blackout the House members were 80:30 in favour of SOPA; 24 hours later House members had switched and the count was 60 in favour and 130 opposed (Cho 2012). By 20 January 2012 the bills (both SOPA and PIPA) were dead.

Rights holders were flabbergasted. Christopher Dodd of the Motion Picture Association of America stated that opponents’ “ability to organize and communicate directly with consumers was a game-changing phenomenon” that he hadn’t seen in more than three decades in public office’ (The Hollywood Reporter 2012). In this case a transnational hybrid coalition of internet pioneers, users, technology companies and citizens succeeded in killing domestic US anti-piracy laws.

As surprising as the anti-SOPA/PIPA coalition’s victory was, even more surprising was the ripple effect that the SOPA/PIPA defeat had on the Anti-Counterfeiting Trade Agreement (ACTA). Inspired by ‘David’s’ victory over the rights holder ‘Goliath’, this transnational coalition now mobilized to kill the USTR’s and rights holders’ plurilateral export: ACTA. In late January and February 2012 a number of countries expressed grave doubts and regrets over having participated in the ACTA negotiations. Massive online and offline public protests in over 200 European cities threw ACTA’s future into doubt. The fact that it had been negotiated in secret profoundly undermined its legitimacy in the eyes of the public (Weatherall 2012, 238). Bulgaria, Czech Republic, Latvia, Estonia, Austria, Germany, Cyprus, Poland, the Netherlands and Slovakia have suspended ratification of ACTA. The European Union has suspended ratification of ACTA, so that the 22 of the 27 EU countries that signed ACTA will not be able to ratify it.

Yet another secret rights holders’ gambit is the plurilateral Trans-Pacific Partnership negotiations (TPP). This again is a vertical forum shift in which rights holders seek an advantage that they can no longer obtain at the multilateral level. ACTA was not a ‘trade’ agreement but rather an intellectual property agreement (Weatherall 2012, 233–34); TPP is an actual trade negotiation. This means that genuine traditional trade issues, such as market access, are being negotiated. TPP negotiations began in 2010 and include the USA, Australia, New Zealand, Chile, Brunei, Singapore, Peru, Malaysia and Viet Nam. Thus far the only leaked chapter available is the intellectual property chapter, which makes clear that ACTA did not go nearly far enough to satisfy intellectual property rights’ holders. The December 2010 leaked chapter included the US requirement that all signatories adhere to the WIPO internet treaties, which a number of countries have chosen not to sign. New Zealand and Chile have objected to key elements of the US intellectual property demands; these have become a real sticking point in the ongoing negotiations. The anti-SOPA/PIPA/ACTA coalition is working to draw parallels between troubling procedural and substantive aspects of TPP to kill the intellectual property provisions (Levine 2012). It remains to be seen whether they will succeed, and as TPP covers multiple issues one should expect issue linkage and trade-offs across various proposals, as we saw in the Uruguay Round with intellectual property, agricultural and textile market access commitments.

Implications for global economic governance

The dynamic and volatile evolution of the global economic governance of intellectual property underscores the unstable and changing relationships between power, paradigms and players. The
financial crisis of 2008 tarnished the Washington Consensus and reduced the USA’s stature as an economic authority worth emulating in every detail. Since TRIPs, power has been shifting toward rising countries such as China, Brazil and India, these rising powers are likely to shape intellectual property policy in the future. One may safely assume that their systems will look different from the OECD’s because of their obligations to members of the ‘bottom billion’ ultra-poor citizens who live within their borders (Collier 2008). Maintaining social and political stability would seem to be nearly impossible if these citizens’ needs go unmet indefinitely. China already is feeling the strain of sharp economic inequality, as its citizens demand more equity and less corruption. Brazil, India and Thailand have availed themselves of TRIPs’ flexibilities in order to better serve their populations’ public health needs and to curb foreign rights holders’ abuses of intellectual property rights.

The rise of the economic power of the information technology (IT) industries has also altered preferences around intellectual property. Google, Wikipedia, eBay and Mozilla have emerged as advocates for a more balanced intellectual property regime to protect safe harbours for internet service providers and resist secondary liability for users’ posting of infringing material. A generational change also has challenged the earlier paradigm of copyright protection as an end in itself (of the 1980s and 1990s); young people have grown up with peer-to-peer file-sharing and downloading digital material. User-generated content enabled by Web 2.0 technologies and distributed via social media like Facebook and Reddit have turned former consumers into creators, blurring the lines between production and consumption. It seems impossible to put the internet genie back in the bottle. Consumers’ desire for digital content that they can enjoy on multiple platforms means that they will find ways to hack around intellectual property until producers provide this option for them. The HIV/AIDS crisis and access to medicines campaign alerted millions of people to the high costs of overly strong patent protection and to the importance of generic competition in providing affordable alternatives to save lives.

Economists of innovation increasingly have questioned the merits of the US system of intellectual property protection. In the past several years a welter of books criticizing this system, which the USA seeks to export and impose on its trading partners, have led many to question the merits of contemporary practice. This deep domestic questioning does not find its way into the USTR and rights holders’ preferences. The SOPA/PIPA/ACTA backlash was a wake-up call. At the very least it is prompting a deeper discussion about the costs and benefits of the current system. It also has engaged a far broader public in this policy space and, given the huge social footprint of intellectual property policy in people’s daily lives, this is a positive development. Issues of such vital public importance should be deliberated as transparently and inclusively as possible. Technology experts were indispensable voices in the anti-SOPA/PIPA/ACTA campaign; it seems unwise to regulate technology without having them involved in the conversation, as was the case before the anti-SOPA campaign.

Whether or not this broadened engagement with multiple stakeholders pressing for greater transparency and balance in intellectual property governance is sustainable is an open question. The multiple levels of governance do not always move in the same direction. For example, while many nation states supported access to essential medicines and policies to facilitate generic competition, WIPO, the US Patent and Trademark Office, and the European Patent Office have provided extensive technical assistance to help developing countries install strong domestic patent institutions that are destined to institutionalize many of the patent pathologies that analysts have identified (Drahos 2010). In many respects this is a darker side to the ‘new world order’ of transnational sub-national networks of experts coordinating behaviour and practices in the interests of efficiency. Anne Marie Slaughter’s vision may be benign when considering competition authorities from OECD countries conferring about procedures, but it appears to be
far more questionable when the distributive consequences are more sinister and political accountability is detached from one’s population (Slaughter 2005; Drahos 2010; Deere 2011). Additionally, private ordering is always possible. While internet service providers resisted SOPA/PIPA, they have also entered into contracts with content owners to give priority to hosting premium content to boost advertising revenues. Google and Facebook have attracted unwanted attention for invasions of online privacy.

Contestation over intellectual property is not going to disappear any time soon. The struggle over what constitutes legitimacy in this policy space will proceed apace. Analysts of global governance need to pay as much attention to the substance of deliberations as they have to the institutional forms and decision rules. They need to highlight the agents who seek to do the governing and their relationships with those whom they seek to govern. As Manuela Moschella suggests,

Legitimacy is more than a property that global economic governance can acquire through institutional reforms, such as decision-making and governance reforms. Rather, legitimacy is an inter-subjective belief about how and why to govern the world economy and it is thereby dependent on a collective audience to be sustained over time.

(2009)

References


The global agricultural trade regime is in the midst of a legitimacy crisis. Despite being shaped by ideas that trade liberalization will bring benefits to all (see Wilkinson, this volume), the regime in practice has locked in an imbalanced set of rules and practices that have contributed to vulnerability in the world’s poorest countries. This system has contributed to hunger and poverty, especially in a world that is facing ongoing volatility in food prices. Although the trade system has been a contributor to vulnerability of developing countries, the global governance response in the face of a growing crisis in the food sector has been woefully inadequate. The World Trade Organization (WTO) Doha Round, although it was supposed to level the agricultural trade playing field, has been deadlocked for over a decade. Meanwhile, the imbalances in the international agricultural trade regime have been further institutionalized through new norms and practices governing global commodity chains in which developing countries participate.

In this chapter, we evaluate the emergence and evolution of the governance of trade in global food and agriculture. We argue that the crisis of legitimacy in the agricultural trade regime is the product of a shift in the key players, their sources of power and perspectives on agricultural trade. We have seen a shift from agricultural trade dominated by the state to a system where private actors have taken a leading role in shaping the rules and practices that govern the system. With the WTO multilateral trade negotiations largely stagnant over the past decade, private actors such as large-scale agricultural commodity trading firms and supermarket chains have taken a key role in shaping the evolving structures that govern trade practices via increasingly complex global commodity chains. The power of these private interests within these commodity chains has also been consolidated through this shift in the trade regime. Along with these changes to the agricultural trade regime has been a shift in perspectives about the conduct of agricultural trade. There has been a profound move away from the ideas that legitimized states’ governance over agricultural trade in a managed way, to trade norms based on liberalization. However, this shift, though evident in much of the rhetoric and discourse around agricultural trade, is not complete in practice. Rich country states have been unwilling to give up their right to protect the agricultural sector, while at the same time they have pushed for developing countries to give up those rights through greater trade liberalization. These shifts in players, power and perspectives in the international agricultural trade regime have led to a system in which production, trade and retail are now much more tightly coupled.
Developing countries that have liberalized their agricultural sectors have become integrated into complex value chains, while rich countries have retained their own complex systems of agricultural protection. The uneven ways in which this transformation has taken place have raised serious questions about legitimacy within the agricultural trade regime. But at the same time, these changes have spawned active resistance and alternative food movements that seek to provide more legitimate means by which to grow and trade food.

In making this argument, the chapter covers three main elements of the agricultural trade regime that reflect these shifts and responses. The first is the system of multilateral rules for agricultural trade. We explain the inclusion of agriculture into the World Trade Organization via the Agreement on Agriculture (AoA), and how this has influenced agricultural trade in practice. We show how liberalization of agricultural trade through the WTO had the effect of simultaneously removing most protections and supports from developing country agricultural sectors while allowing developed countries to maintain supports and protections virtually unabated. Second, we examine governance over global food and agriculture supply chains. Here we overview the issues of retail concentration, notably with European supermarket oligopolies, and of safety and quality standards established both through supply chains and international rules, which are not completely independent of the AoA. Finally, we examine challenges to the legitimacy of the current agricultural trade regime, giving an overview of the movements that have emerged to resist the regime, with particular emphasis on the fair trade and food sovereignty movements. These movements aim to work in alternative spaces that actively resist the shifts in power, perspectives and players in the agricultural trade regime. Although these movements have grown in recent years, fractures remain within and between these movements and it is not clear how much of the world’s agricultural trade they can govern.

Multilateral agricultural trade rules

In 2008 the value of global food trade surpassed US $1,100,000m., up from just $315,000m. in 1990–91 (Aksoy and Ng 2010). This huge jump over the past two decades occurred alongside the shift from a more managed international trade regime to one that was based on liberalized agricultural trade. Food and agricultural goods were largely exempted from international trade rules prior to the 1990s (Jawara and Kwa 2003). Agricultural products were technically covered under the 1947 General Agreement on Tariffs and Trade (GATT), but in practice the GATT rules did not hold for food and agriculture, and members put in place complex systems of agricultural trade protection. Tariffs, quotas, export and domestic subsides and other policy tools were used to provide protection to the agricultural sectors in many countries. The USA, Europe and Japan in particular put in place such protections in a bid to both secure export markets and protect the viability of their farm sectors. Many developing countries protected their agricultural sectors in similar ways (Aksoy 2005).

Years of subsidies and other forms of protection, particularly in the industrialized countries, put downward pressure on prices for basic staples like wheat, maize and rice, which in turn had negative implications for a number of countries. By the 1980s, cheap grain on world markets became a major challenge for local producers in developing countries who found it hard to compete. Although many developing countries were net exporters of food in the 1960s, many, including many sub-Saharan African countries, had become net importers of food by the 1980s (FAO 2005). Other agricultural exporting countries, including Australia, Canada and Argentina, were also negatively affected by especially high levels of agricultural protection among the major players, especially the USA and the European Union (EU), which made it difficult for other states to compete in export markets, particularly for grains.
Early agricultural trade liberalization in the South

A wave of agricultural trade liberalization began in developing countries in the 1980s. This policy shift in the South was largely imposed from the outside. Many developing countries across Africa, Latin America and Asia began to adopt structural adjustment programmes (SAPs) in the 1980s as conditions attached to debt restructuring in the wake of the developing country debt crisis. These adjustment programmes, designed by the International Monetary Fund and the World Bank, required structural economic changes, including the liberalization of trade and investment policies (Bello 2009). These measures had a significant impact on the agricultural sectors of these countries, which typically had been protected by policies that were not that dissimilar to those practised by the industrialized countries. These included tariffs on imported goods, taxes on agricultural exports, set-prices on some agricultural products, subsidies for agricultural inputs and restrictions on foreign direct investment (see Clapp 2012a).

The removal of the protections for the agricultural sector had a mixed result in developing countries. The liberalization of agricultural prices in many cases was welcomed because it brought farmer prices closer to the world price for export crops. But at the same time there was a surge in food imports in many adjusting countries, which threatened local farmer livelihoods (FAO 2003; South Centre 2009). The reduction in tariffs and other trade barriers meant that heavily-subsidized grains from industrialized countries could now flood into these countries. As imports climbed, developing countries that undertook adjustment programmes also gave up the use of tools such as tariffs and export taxes that had previously been used to raise revenue for agricultural investment.

The Uruguay Round and the birth of the Agreement on Agriculture

While developing countries were undertaking liberalization of their agricultural sectors under some duress, the industrialized countries continued to practise agricultural trade protection well into the 1980s. But the rising costs to maintain the system of agricultural supports, which amounted to approximately US $300,000m. per year in the Organisation of Economic Co-operation and Development (OECD) countries by the mid-1980s, led the USA and the EU to support the idea of formally including agriculture as a sector to be liberalized under multilateral trade rules of the GATT (Diakosawas 2001). The Uruguay Round of trade negotiations, launched in 1986 in Punta del Este, Uruguay, included the negotiation of an Agreement on Agriculture that sought to drastically reduce agricultural trade barriers and distortions (Balaam 2004). The Uruguay Round was finally completed in 1994. The agreement called for liberalization of agricultural trade along three key dimensions: market access, domestic support and export subsidies (Aksoy 2005).

The market access provisions of the AoA were aimed at improving agricultural exporters’ access to foreign markets. These provisions called for a reduction in tariffs and removal of quantitative restrictions on imports. Rich countries were to cut tariffs by a third over six years, while developing countries were to cut them by 25% over 10 years. The agreement also required members to commit to importing a minimum level of agricultural products that they consume. Domestic supports for agriculture were also to be reduced under the agreement. Farm subsidies in rich countries were to be cut by 20% from their 1986–88 levels over a period of six years, and developing countries were to cut them by 13% over a period of 10 years. The idea of these provisions was to reduce reliance on subsidies and to reduce the downward pressure they put on international agricultural prices. Export subsidies were also cut in a bid to eliminate the dumping of agricultural products at below the price of production. Developed countries were
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to reduce the value of agricultural export subsidies by just over a third over six years. Developing countries were also required to reduce export subsidies by a quarter but were given 10 years to implement these changes. The least developed countries were exempted from most of these provisions (GATT 1994).

The Uruguay Round Agreement on Agriculture represented a broadening of the shift in perspective toward more liberalized agricultural trade. However, this shift has been fraught and incomplete, as a number of exceptions to the rules rendered it weak as an instrument of trade liberalization (Ritchie 1996; Watkins 1996). The weak spots in the rules were largely the product of USA–EU brokering during the negotiations (reflecting their long history of self-interested trade negotiations—see Wilkinson, this volume) and as a result provide an ‘out’ for each of these major trading partners from making major changes to their agricultural policies.

One of the major exemptions was created when the members agreed to create a variety of coloured ‘boxes’ to label different types of agricultural subsidies. The idea was to indicate the extent to which different subsidies were seen to be trade distorting. Subsidies placed in the ‘amber’ box were labelled as trade distorting, and thus subject to reduction amounts and schedules noted above. But some subsidies were placed in a ‘green’ box of subsidies that are seen to be non-trade distorting (for example, income supports for farmers, land set-aside payments, crop insurance and expenditures on research and extension) and were allowed to continue with no limits or cuts at all. A ‘blue’ box was also created for subsidies that typically would fall into the amber box, but which were exempted because they required farmers to limit production, a feature that made them somewhat less distorting to trade. Subsidies placed in this box were also exempted from any cuts (Aksoy 2005).

Further weakening the rules was the fact that the base period for those subsidies that were to be cut under the agreement was set at periods that saw historically high levels of subsidies. This meant that the cuts were to take place from very high levels to begin with, such that when the cuts did occur, they did not necessarily result in cuts from the current levels of payment. The base period for reduction of export subsidies was 1986–90, and for domestic support subsidies 1986–88. The agreement also included a Peace Clause, which the USA and the EU insisted upon, that prohibited legal challenges to subsidy levels for a period of 10 years (Clapp 2006).

Finally, the rules on market access enabled tariff cuts to be made in a highly uneven fashion. Although cuts were to be made to taxes on imported agricultural products, the rules allowed the cuts to be averaged across products. This meant that members could make steep cuts on some items, while maintaining high levels of tariffs on other products. In practice, the rich industrialized countries tended to maintain high levels of tariffs on products typically exported by developing countries, such as groundnuts, sugar and meats. Tariffs on these products often are as high as 500%. Industrialized countries could also continue to apply lower tariffs to unprocessed goods and higher tariffs to processed goods. This practice, termed ‘tariff escalation’ undermines incentives for developing countries to process and thus capture more of the value added of the agricultural goods that they export (Aksoy 2005).

These and other loopholes in the Uruguay Round Agreement on Agriculture meant that the shift toward liberalized trade in agriculture was only partial. Moreover, it was the industrialized countries that managed to get most of the breaks in the deal. Developing countries, most of which had already liberalized their agricultural trade policies under programmes of structural adjustment a decade earlier, had relatively much steeper changes to make to their policies than the rich countries (Khor 2009). The effect was an institutionalization of the uneven playing field for agricultural trade. Indeed, agricultural subsidies climbed to higher, rather than reduced, levels after the agreement came into place, to a total of $330,600m. by 1998–2000, largely because some 60% of OECD country agricultural subsidies were placed in the green and blue
boxes (Diakosawas 2001; OECD 2001). At the same time, developing countries did not see their share in agricultural exports to the industrialized countries increase; they experienced further surges in imports of basic grains into their markets.

**WTO Doha Round and attempts to reform the AoA**

The unbalanced nature of the agricultural trade rules under the Uruguay Round was widely recognized at the time that the Agreement on Agriculture was negotiated. WTO members incorporated a built-in agenda item to revisit the agreement in the next round of trade talks. Agriculture became the centerpiece for the Doha Round of WTO trade talks, launched in 2001. The Doha Round talks saw a shift in the key players who influenced trade negotiations. While the USA and EU took the lead on shaping the outcomes of the Uruguay Round AoA, developing countries asserted more voice into the Doha talks through new negotiating groups, the Group of 20 (G-20—agriculture) and the Group of 33 (G-33) (Narlikar and Tussie 2004; Narlikar and Wilkinson 2004). However, the provisions that these groups pressed for were subject to much debate and resistance from the industrialized countries. As a result, the round has been largely stalled for at least the past five years (Scott and Wilkinson 2012). Although the Doha Round was aimed at completing the shift in perspective toward liberalized agricultural trade, the stalling of the round has put that shift on hold.

The Doha agriculture talks progressed in brief fits and starts from the very beginning, with lack of a clear momentum toward a more balanced trade deal (Josling and Hathaway 2004; Anderson and Martin 2005). Developing countries were promised ‘special and differential treatment’ (SDT) in the round (WTO 2001), although this point seems to have been lost somewhere along the way during the negotiations. Despite the initial intention to complete the round by 2003, the talks have well overshot the original timeline by more than a decade. Some of the key issues that stalled the talks were linked to the issues that developing countries were pushing as part of what they argued were legitimate requests to build in SDT into the agreement. The G-20 agriculture negotiating group, comprising 20 developing countries and led by India and Brazil, called for significant cuts to industrialized country agricultural subsidies and tariff reduction schedules that phased out unfair practices such as tariff escalation. The G-33 also emerged as an important group in the negotiations, as it pushed for exemptions from tariff cuts for ‘special products’ that are important for farmer livelihoods, and a special agricultural safeguard mechanism that would enable developing countries to protect themselves in cases of import surges that threatened to outcompete local food production (Clapp 2006).

As these new developing country coalitions in the trade talks attempted to make their concerns heard, the USA and the EU remained key players in the talks and continued to push for their own agendas. Although the talks began with a focus on special and differential treatment for developing countries, the tone soon shifted to the industrialized countries’ concerns about what it would mean for their own agricultural exports if they granted that treatment. By late 2008 the offers on the table remained weak. The rich industrialized countries agreed to reduce their own domestic subsidies by minimal amounts, in fact to levels that were above what was being paid at the time, thus requiring no change in practice for those countries. Meanwhile, the industrialized countries argued for restrictions on the use of any special safeguard mechanism (SSM) for developing countries (Clapp 2012b). The negotiations broke down in mid-2008 over this very issue, despite the fact that this was during a major global food crisis that saw food prices and hunger levels soar. As Martin Khor of the South Centre noted, the December 2008 draft rules remained ‘grossly imbalanced against developing countries’ (Khor 2010). In the meantime, high food prices on global markets have meant a significant increase in food import...
bills of developing countries that had become dependent on imports following market liberalization (De Schutter 2011).

Agricultural commodity chains—a new arena of agricultural trade governance

As agricultural markets have become more liberalized, private governance has also become prominently fixed in the governance of agricultural trade, which itself has become more locked with both food production and retail. Power has in many ways shifted from state players who managed trade through multilateral rules, as noted above, to more privately organized commodity chains in which intra-firm trade dominates. In this shift towards private governance, increasingly consolidated transnational supermarket chains (TSCs) and hypermarkets (most notably Walmart) have emerged as powerful players in the global agricultural trade regime, restructuring agricultural commodity chains and relations therein. Ways in which this has been starkly pronounced include structuring of private standards and the expansion of contract farming by TSCs (Murphy 2006). This transformation has been particularly significant for small producers producing for export markets and has both reflected and reinforced broader trends in governance embodying the withdrawal of the state in governance and the embedding of private authority over commodity chain relations.

Supermarkets as central actors in global agrifood commodity chains

It can be argued that supermarkets provide important opportunities to agricultural producers in the South. Grocery retailers have increased demand for high-value non-traditional agricultural exports, including fruit and vegetables, which have provided unique opportunities for producers in developing countries. Furthermore, retailers have integrated socially and environmentally sustainable products, such as organic and fair trade, into their production lines, and are potentially a location for consumer activism (Murphy 2006, 36; Watkins 2008; Fuchs, Kalfagianni and Arentsen 2009). But the concentration of supermarket chains has transformed agricultural production for export markets, and relations along global commodity chains for export commodities, which has created new complexities in the governance of trade over food and agriculture, as new players, powers and paradigms have taken shape.

Food retail has become increasingly concentrated over the last 20 years, both within countries and globally, raising concerns that oligopolies are forming and compromising market competition, with global impacts. In the UK, four retailers hold about 75% of the market share (Guardian 2011) and in Australia, just two retailers hold 70%—80% of the country’s supermarket market share (in gross dollars; Boley 2012). In the USA, the situation is a little different, with market share somewhat more evenly spread across traditional supermarkets, but with Walmart holding an estimate of 33% of the market share in food retail (Forbes 2011). Transnational supermarket chains are establishing a stronger presence in developing and emerging economies as well. Globally, in 2004, the top 10 supermarkets in the world accounted for almost one quarter of the global food retail market share, with Walmart accounting for the highest market share. After Walmart, supermarkets make up the top retailers in the world: beginning with France’s Carrefour, then the UK’s Tesco and finally Germany’s Metro, attributable in significant part to their expansion into emerging markets (ETC Group 2005).

The concentration of retailers and their subsequent rise to market power have shaped developments that have generated significant challenges to small farmers in the South, as well as in the North, placing pressures down the commodity chain as each link in the chain tries to
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profit (Burch and Lawrence 2005, 4). Producers, particularly small producers, rest at the bottom of these chains, possessing minimal market power and often receiving the brunt of these pressures. Concentration has also given rise to quality and safety standards that are privately set and monitored by supermarkets, where producers have borne the majority of costs for meeting these standards. Related to this is an increased shift towards contract farming, where TSCs contract producers, requiring them to absorb the costs and risks of production for export markets. These developments reflect the growing trend in global economic governance towards private governance and government withdrawal, and the concomitant power asymmetries characterizing the global economy.

With consolidation has come increased competition among supermarkets, which further concentrates the sector and other sectors down the commodity chain. Supermarket retail returns tend to be low, at 3%–4%, necessitating lower transaction fees and other avenues to retain profit margins amidst growing competition (Burch and Lawrence 2005, Reardon and Timmer 2008). To achieve this, major supermarket retailers rely heavily on procurement practices that keep transaction costs at a minimum and offer additional profit margins, leaving those unable to follow suit struggling to compete, and frequently subsumed by the major retailers. A shift towards increased centralization and the use of wholesalers to keep transaction fees lower and profit margins higher has also been embraced. The more consolidated the supermarket chain, the greater advantage of centralizing procurement, in contrast to less efficient and more human-capital-intensive procurement by individual stores. While shy of actual vertical integration by supermarkets, the wholesale sector devoted to supermarkets provides reduced transaction and search costs, enforces private standards and contracts on behalf of the markets, and effectively manages a ‘preferred supplier system’ in the interests of supermarkets (Reardon and Timmer 2008, 199–200).

The significance of private standards

On top of centralized procurement systems, private quality and safety standards, along with the rise of contract farming, have amassed a great deal of attention in the global political economy literature of agricultural production and trade, vis-à-vis supermarket and hypermarket chains. For many, these practices represent the core of the changing relations of power in global agricultural systems, giving supermarkets and hypermarkets significant market power as well as influence over the rules that govern agricultural trade (Daviron and Gibbon 2001; Murphy 2006; Fuchs et al. 2009). Quality, safety and social-ecological standards appeal to discerning consumers concerned with the global food system. Standards can build relationships of trust, bridging the distance between consumer and producer in an increasingly globalized agricultural system (Reardon et al. 2001, 427). Standards assuring safety and quality have become a central feature of supermarkets. At a time when food scares such as BSE, e-coli and food contaminants (like melamine in baby formula) have plagued the industrialized and globalized food system, food production has had to ramp up its assurance to consumers that their food is safe. At the same time, a certain level of quality to food has become expected from consumers shopping at large supermarkets. Meanwhile, though less prominent, private standards have extended increasingly to social and environmental qualities, such as organic, genetically modified organism–free and fair trade (Murphy 2006; Daviron and Gibbon 2001).

Private quality and safety standards, while they act on the surface as a service to consumers, are more deeply rooted in the interests of supermarkets, who have used them to elevate their power within the global food system. Retailers can use private standards as a means to reduce competition in their own sector; standards carry high transaction costs and thus require tight and
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efficient coordination and management to keep costs low (Reardon et al. 2001, McCluskey 2007). Private standards are also a form of market differentiation among supermarket chains, providing further advantages in the highly competitive retail sector (Reardon et al. 2001).

Private standards exist both by the initiative of individual supermarket organizations, notably in their own brands, and through collective and sometimes more international initiatives, such as the Global Food Safety Initiative, GlobalGAP and the Ethical Trading Initiative (Fuchs et al., 2009, 35). Retailers use their own brands to entice consumers by establishing the trust that their products provide safety and quality: a name they can trust. Where supermarket brands once intended to provide consumers with ‘low-cost alternatives’, they are today transitioning towards being ‘premium brands’ and have become leaders in providing ‘new food products’—home meal replacements, convenience foods, prepared fresh food, snacks, and other product lines for ‘flexi-eating’, which traditional brands are not in a position to supply (Burch and Lawrence 2005, 1–2). However, private collective standards are better able to induce supplier participation, while allowing retailers to maintain control over standards and their implementation. Unlike with existing global standard certification bodies, notably the UN Codex Alimentarius, retailers are able to have greater control over who participates in private collective standards-setting processes, and in what capacity, marginalizing others in the commodity chain, such as suppliers, producers and developing country representatives. European countries, for example, dominate the GlobalGAP initiative, while the Global Food Safety Initiative limits access to retailers, effectively marginalizing others in the supply chain subject to conditions set by the standards (Fuchs et al. 2009, 37).

Conditions created by private standards can be especially unfavourable to smaller and poorer farmers and smaller firms. Consolidation in one part of the chain tends to lead to consolidation in another part of the chain, as centralized systems that guide food from production to trade to retail tend to prefer working with other centralized systems, thus favouring greater concentration up the chain (Murphy 2006, 16). For firms, private standards tend to favour more centralized retailers, who have an advantage because they have the resources to hold a highly refined coordination and management system. This highly coordinated system then tends to prefer more centralized processors, distributors or manufacturers because they carry lower transaction costs (Reardon and Timmer 2008, 191; Daviron and Gibbon 2002, 142). This system often disadvantages small farmers. Being many and dispersed, small farmers are more costly to coordinate, trace, monitor and enforce, disadvantaging them relative to larger farmers (Reardon et al. 2001). Standards, as they transform the global agri-food system into a ‘more capital-, technology- and management skill-dependent’ system (Fulponi 2008, 7–8), necessitate investments in resources that small farmers often cannot afford, such as storage and refrigeration facilities (Reardon et al. 2001, Kirsten and Sartorius 2002, 504). Even though standards potentially produce higher profits for both producers and retailers, producers tend to absorb the higher costs in this system of production coordinated by retailers, such as the investment in technologies and infrastructure (Fulponi 2008, 12), which can outweigh profitability from participation (Takane 2006; Singh 2002).

Contract farming within global agricultural commodity chains

Consolidation of supermarket chains and the related shift towards private standards has also cumulated into an increased push for contract farming to supply local and global markets (Reardon et al. 2001, 428; Kirsten and Sartorius 2002). Contract farming centralizes relations between producers and procurers (whether manufacturers, processors, distributors or supermarket chains). This relates further to maintaining the tight coordination and management
needed to remain competitive, the traceability necessary to ensure safety and economic efficiency to reduce transaction costs. It also helps provide a stable supply of bulk quantities exhibiting uniform quality, helps avoid direct labour relations and overcomes constraints on land ownership (Swinnen et al. 2008; Kirsten and Sartorius 2002, 511–15; Singh 2002, 1624; White 1999). Contract farming can also provide gains for farmers. Contractors might provide credit, enabling farmers to access technologies, information and inputs needed to meet the emergent quality and safety standards that have become de facto requirements in supplying the global market, especially TSCs. Contractors might also provide guaranteed prices, markets and incomes for farmers on what are characteristically unstable markets (Murphy 2006; Singh, 2002; Kirsten and Sartorius, 2002; White, 1999).

However, the gains from contract farming are questionable. Once again evidence suggests that this system, while offering potential opportunities for small farmers, often presents challenges instead. Contract farming tends to benefit larger farmers, who are more centralized and carry lower transaction costs than contracts with smaller farmers and who provide bulk quantities of consistent quality in ways that small farmers cannot (Kirsten and Sartorius 2002, 519; Singh 2002). Producers lack the negotiating power to set the terms of the contract, so that those with more power in the chain (retailers, manufacturers, distributors and processors) have the ability to set the terms of prices and value-added on products. Contracts lock producers at unfairly low prices, reduce market transparency and compromise price discovery (Murphy 2006, 15). Small farmer access to technologies and production inputs for changing markets often requires loans carrying interest payments and administrative fees, which may mean that the cost of production calculates higher than the income earned, generating debt rather than net income (Masakure and Henson 2005; Kirsten and Sartorius 2002; Singh 2002; White 1999).

Contractors also download transaction costs (storage, transportation, delivery, costs to administer contracts) and market risks (crop failure due to weather and disease, price volatility and poor quality produce) onto farmers (Murphy 2006; Singh 2002; White 1999). One study finds that some contractors underpay for products, overcharge for their services, turn away products without explanation, set prices below market prices, delay payments for products by months and provide poor extension services (Singh 2002, 1625–26). Some contract conditions might mean that by the time everything is repaid, farmers will require new loans to overcome declining productivity (White 1999). Contract farming is also linked to environmental degradation, social alienation and differentiation, the disruption of traditional community arrangements and social institutions, and the generation of adverse gender and labour relations (Korovkin 2005; Singh 2002, White 1999). Finally, evidence shows that some firms extract the profits related to production, such that they are not reinvested in local communities, defeating a significant point of their purpose (Singh 2002). Such contract conditions do not just hold true to relations with developing country producers; rich country farmers, especially livestock farmers, have also suffered greatly under similar conditions, with many farmers unable to sustain their livelihoods under existing contract conditions (Collinson 2012; Singh 2012).

To be sure, the challenges associated with contract farming vary with each context; different companies might impose different contract conditions and different crops might favour different sized farm-holders (see Takane 2006, 36–38). Nonetheless, the above findings do reflect trends that have been identified across a wide body of literature. However, Singh, critical of the outcomes of contract farming, argues ‘it is not the contract per se however which is harmful, but how it is implemented in a given context’ (Singh 2002, 1626). Despite trends and negative outcomes for farmers, evidence supports that farmers wish to continue with contract farming in order to maintain access to markets and inputs, and that some farmers wish to retain the status of prestige associated with export agriculture (Singh 2002, 1624; Masakure and Henson 2005,
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1729). The problem, ultimately, is the unmitigated power within the global agricultural trade regime.

The concentration of supermarket oligopolies, and the affiliated practices of standard-setting and contract farming, have far-reaching impacts on how production and trade of food and agriculture is structured and are a reflection, and reinforcement, of who holds power in the changing system. Intermediaries, such as manufacturers, processors and distributors, were once considered the market power in agricultural commodity chains. However, the increased consolidation of the retail sector has transferred a significant portion of this power to retailers (Watkins 2008; Reardon and Timmer 2008; Murphy 2006; Burch and Lawrence 2005). Murphy defines this specifically as market power; that is, ‘the ability to affect price, to reduce competition and to set standards for a sector of economic activity’ (2006, 9; see also Fuchs et al. 2009, 35–36). Retailers, the new wielders of power within food and agriculture markets (along with grain traders), are shaping what farmers do through contracts and pressures down the chain. They are also overturning the traditional roles of intermediaries.

Others suggest that this is more than a transfer of power, but that the power born of the consolidated supermarket sector is fundamentally systemic: representing the rise of a third ‘food regime’ (Burch and Lawrence 2005). Private standards as market differentiation, in this view, are more than a response to demand, but are part of broader shifts shaping consumption to the benefit of competing retailers. Effectively, transnational supermarket firms are both shaping the direction of food consumption and the process of production and procurement down the food chain on a global scale. Generally, the rise of supermarkets has fundamentally impacted who holds power in the global agricultural trade regime, and the character of governance over sectors of the regime, including over global commodity chains.

The legitimacy crisis and growing resistance

The legitimacy of current governance over global trade in food and agriculture is in crisis. The arguments promoting a paradigm of liberalization are faltering, though the paradigm is in no way defeated, under the deepening understanding of its destructive impacts. The traditional power of rich countries for pushing policy directions is increasingly being challenged by emerging economies, notably Brazil, as well as developing countries operating in coalitions like the G-20 and G-33 agriculture coalitions in the WTO. Civil society and social movements are engaging as well, like never before, becoming powerful players in stalling the traditional power of particular states, in direct global and national policies, and in directly resisting and challenging the paradigm of liberalization. Meanwhile, there is evidence that states are taking some notice of governance shortfalls. In the UK, for example, supermarkets have faced competition scrutiny by government on a variety of issues, with expectations that a supermarket ombudsman will be appointed in 2013 to oversee competition concerns (Thompson 2012). None of these challenges is perfect, but they do demonstrate a very real crisis of legitimacy within the existing global agricultural trade regime.

While the retreat of the state is certainly a central feature in the liberalization paradigm governing global trade, particular states have been powerful in pushing for this paradigm, albeit selectively and to their own market interests (Clapp 2006, Wade 2003). This factored most prominently with the establishment of the WTO, and the AoA therein. However, the AoA and the SAPs that preceded them have illuminated the destructive impacts of uneven agricultural liberalization. This has led developing countries to coalesce in resistance to further agricultural liberalization and to push against this paradigm in favour of increased protections, countering the traditional imbalance of power favouring rich country states. We see this both with fewer
developed countries entering coalitions with emerging economies, most notably Brazil, but also in coalitions that are independent of, and sometimes at odds with, some of these emerging powers, such as with the G-33. This is evidenced above within the WTO, culminating in the stalling of the Doha negotiations through resistance to further unequal and harmful liberalization. These coalitions have empowered developing countries in global negotiations. This is a crucial shift in power in the governance of trade. At the same time, power asymmetries favouring industrialized countries persist, particularly within bilateral and multilateral trade agreements, which have proliferated exponentially over the last decade. While we see new locations of power emerging, we continue to see the old locations of power maintaining their roots through new institutions to preserve their interests.

A more forceful challenge to legitimacy of the liberalization paradigm, and of the disproportionate power of rich country states (and at times emerging economies—such as in the G-20 leading economies as extended from the Group of 8), has come from social movements and civil society organizations. While there are many organizations and movements engaging various efforts (Borras et al. 2008, 171), we exhibit two for this chapter—the fair trade and food sovereignty movements.

As a movement, fair trade is more than just the oft-associated expansion of labelled consumer products to help small producers. While helping producers and workers with acquiring more equitable remuneration for their products, fair trade has also been pivotal in discrediting liberalization and current commodity chain relations, bringing awareness of their harmful impacts on small producers across the globe. Where once the argument was common that ‘free trade is fair trade’, we don’t see this as often anymore. Indeed, in a 2010 debate hosted by the usually liberalization-minded Economist, it was voted that trade should be fairer rather than freer (Economist 2010). While their efforts are very imperfect, and arguably even often disingenuous, we see as well that today most companies need to accredit themselves for taking concerted efforts towards more favourable social and economic relations with producers. This is also arguably of credit to the fair trade market, which has expanded awareness that commodity trade can be harmful to producers. While the 1960s and 1970s also saw rapid expansion of more solidarity-oriented alternative trade organizations (ATOs) and their direct-sales networks, it is the more mainstreamed work of Fairtrade International (FLO) that has seen remarkable market growth. Global sales in fair trade products have seen 40% growth every year over the five years leading up to 2009, and demonstrated exceptional resilience to the global economic crisis, with sales reaching €3,600m. in 2009, with a 10% increase in France alone (Avril 2010). As more individuals and companies choose fair trade products, there has been unquestionably an expanded awareness that the dominant trade structures are harmful to producers around the world.

The fair trade challenge to the legitimacy of dominant paradigms and players is not limited to the market element of the movement. Fair trade embodies broader efforts by activists, ATOs, and civil society organizations (CSOs), seeking more systemic change; that is, new paradigms governing trade in food and agriculture. The term ‘fair trade’ itself links to a post-war ‘statist’ development agenda, which sought more equitable trade arrangements between developed and developing countries, working through the United Nations (Lyon and Moberg 2010; Fridell 2007). Since the 1980s opportunities to shape policy for more equitable trade have diminished as ‘free’ trade policies have prevailed. Nevertheless, some advocacy work has continued, most notably through Oxfam’s Make Trade Fair Campaign in the early 2000s, and through various organizations within the movement, including the work of the Fair Trade Advocacy Office and the Fairtrade Foundation, which have engaged, albeit minimally, to shape more just trade policy. Such efforts represent more systematic challenges to the legitimacy of existing paradigms and power players.
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On the one hand, the role of the mainstream fair trade market is highly contested within the movement. Many voice concerns that the mainstreaming of fair trade has legitimized the paradigms and powers it was designed to delegitimize, especially with the certification of companies like Nestlé, Starbucks and Cadbury, and with a focus on volume over value, which has compromised efforts of solidarity that are central to the movement and found in the work of ATOs (Fridell 2007; Raynolds et al. 2007; Lyon and Moberg 2010). There are also criticisms that, as a market mechanism, fair trade reinforces private-led governance and the neo-liberal doctrine for the withdrawal of the state, compared with the earlier, more political efforts of the movement (ibid.; see also Bacon 2010). At the same time, one could argue that mainstreaming has created more systematic awareness that has delegitimized existing governance of trade and created increased opportunities to challenge liberalization and commodity chain relations, at least since the 1980s. Arguably, and regretfully, the problem here is that the movement has not mobilized on some political opportunities with a renewed focus on policy spaces, which is essential for more far-reaching transformations of the paradigms that fair trade seeks to change (Burnett, forthcoming).

Where fair trade has not mobilized around political opportunities, food sovereignty has. Food sovereignty, especially through the work of La Via Campesina and the International Planning Committee (IPC) for Food Sovereignty, is a transnational agrarian social movement forcefully challenging the global agricultural trade regime and its underlying powers. Food sovereignty demands new paradigms and players in shaping the governance of agricultural production and trade, most notably that farmers and governments should have the right determine their own food policies. Food sovereignty launched with Via Campesina in the early 1990s to confront the integration of agriculture into the World Trade Organization. Food sovereignty contests that the existing and expanding system of global agricultural production and trade is economically, culturally, socially and politically harmful to peasants, small farmers and indigenous and other food producers throughout the world (Wittman et al. 2010). The movement is particularly concerned with the undemocratic nature of trade agreements generally, including not just the WTO, but regional, bilateral and other multilateral trade agreements as well, which they argue are controlled by the interests of transnational corporations and promote ecologically destructive agricultural production. The movement takes particular issue with liberalization, most favoured nation and non-discrimination rules, which have become embedded within the WTO (Windfuhr and Jonsén 2005). One of the rallying cries of the food sovereignty movement has been to get ‘the WTO out of agriculture’ (Via Campesina 2003, 3).

The movement demands that states and peasants have the rights to determine their agricultural policies and methods of production, and for producers to have rights to resources. The movement has worked actively in resistance to particular agricultural governance fora with explicit efforts to delegitimize them—such as the G-8 and G-20, the World Bank and the International Monetary Fund (IMF), in addition to the WTO and trade agreements. It pushes for governance to be relocated to the United Nations, which it holds to be more democratic through the principle of ‘one country, one vote’ (Via Campesina 2009a, 2009b). The movement has been especially active in the reformed Committee on World Food Security (CFS) of the Food and Agricultural Organization (FAO) of the United Nations. The CFS is seen to be a democratic space to shape policy for governance not only because it is democratic among states, but because it allows civil society to have an active voice through the civil society mechanism (CSM) and as official advisory board members. Food sovereignty has actively engaged in both of these spaces. The IPC for Food Sovereignty was a member of the official advisory board for two years, and Via Campesina and other members of the movement have participated prominently in the CSM.

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However, while the food sovereignty movement has been very active in articulating how it does not want trade governed, and has actively engaged in carving out the spaces it wants to see governed, details are missing on how the movement wants to see trade governed. In fact, the movement’s view on trade generally remains somewhat ambiguous. While the movement promotes local markets above, and indeed before, trade, it is unfairly characterized as promoting food self-sufficiency (Kerr 2011; Southgate 2011). Some affiliated with the movement remain more starkly critical of production of agricultural export commodities (Oakland Institute, N.D., Rosset 2006). However, more accurately, the movement has expressed a prioritization on production for local consumption, and that imports not displace this (International Nyéléni Forum for Food Sovereignty 2007). It is unclear how, and even if, the movement represents those producing for export markets. That said, a few statements give some indications of their position. At the 2007 Forum for Food Sovereignty in Néléni, it was stated ‘fair trade initiatives and other arrangements should be supported’ (International Nyéléni Forum for Food Sovereignty 2007). At the same conference, transparent trade is promoted, where trade ‘guarantees just incomes to all peoples as well as the rights of consumers to control their food and nutrition’. Generally, it has been argued that the movement is not against trade per se, but is against the current system that works against the interests of smallholder farmers (Windfåhr and Jonsén 2005, 32). In all, more could be done to clarify how the movement would like to see trade governed; while questioning the legitimacy of the existing regime is important, having a clear position on how governance should take shape in the aftermath is also crucial to moving forward.

Conclusion

We have demonstrated in the chapter that the significance of key players in governing the global agricultural trade regime has shifted with the move from a state-based agricultural trade system to one dominated by private interests, namely large corporations that dominate agricultural commodity chains. This is in line with the dominant liberalization paradigm governing the system, which favours privatization and export-oriented production over producing for local markets and which locates and concentrates power further in the hands of private actors. Increased trade liberalization, albeit selectively, has removed the state from supporting agricultural sectors, and from protecting them, particularly in developing countries. However, at the same time, many supports and protections, often veiled and contrived, and at times even illegal under WTO rules, persist in rich countries. Overall, this unequal trade liberalization regime favours the interests of agribusiness and large farmers in rich countries, while disadvantaging small farmers around the world. Meanwhile, governance has been further privatized with new norms and rules that guide practices in global commodity chains. Within these structures, transnational supermarket chains have taken a leading role in setting private standards and in establishing contracts directly with farmers, and in the process production, trade and retail have become much more tightly linked. The organization of agricultural production and trade in this way has facilitated the continuation, and deepening, of an uneven trade liberalization paradigm, in effect giving rich countries further access to and control over developing country agricultural sectors.

However, we have also demonstrated that the players, power and paradigm governing global agricultural trade are not static in and of themselves, and are facing a crisis of legitimacy. Ironically, the stall of the Doha Round of trade negotiations occurred just as new developing country coalitions demanded a more even set of trade rules for agriculture. New coalitions of developing countries within the WTO have actively challenged the liberalization paradigm that diminishes state authority and agricultural policy space. But, while the South’s challenge to the North has sparked heated debate over how to move the regime forward, it also has met with great resistance by the rich countries.
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Social movements have emerged as new players in this changing context, yielding new powers and challenging the existing paradigm as well. The fair trade movement, despite its shortcomings and persistent questions around its priorities, has arguably done much to discredit the legitimacy of ‘free trade’ dogmas. The food sovereignty movement has engaged extensively in challenging and shaping agricultural policies, but still has a limited view on what trade policies are important in moving forward, and is perhaps limited in its strategy for how a new trade regulation regime might emerge from the complex power relations that underlie trade.

Despite challenges to its legitimacy, liberalization persists as the dominant norm guiding agricultural trade, although it has been only partial and incomplete in practice. The rules, norms, practices and processes of global agricultural trade still have far to go in achieving a more level playing field that is equitable for all stakeholders engaged in and impacted by trade. The current players, power structures and paradigms governing trade are not immutable, but they are deeply rooted and still pose many challenges going forward.

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Part II

Global governance of finance and money
The historical origins and development of global financial governance

Randall Germain

Introduction

This chapter canvasses the origins and historical development of what we today call ‘global financial governance’. As a problem, financial governance can be located within the field of ‘political economy’, because it sits at the intersection of economic and political relations as defined by the mutually constituted organization and operation of markets and states (or governments). Since the early modern period, roughly the 17th–18th centuries, a ‘global’ political economy has taken shape around the consolidation and extension of the capitalist market economy, together with the birth and growth of the modern state and its attendant interstate system. For this reason the creation of value and wealth made possible by capitalism and its social hierarchies has been organically connected to the organization and exercise of state power.

The international organization of finance has been an explicit concern of governments since the latter years of the 19th century, when the world’s financial and monetary systems became centralized around the operation of the London markets and a handful of financial institutions operating out of the City (as the London financial district is called). The growth of financial governance at the global level has paralleled both the growth of state power over this time and the growing complexity and diversity of financial markets and the institutions that operate in them. It has also responded to pressures from interest groups that have sought to influence financial activity in ways that align with their (often differing) economic and moral concerns. One key theme to emerge from any narrative of global financial governance, therefore, is its explicit political dimension, even if this has meant different things to different actors over time.

This chapter is organized in three parts. The first section examines the 19th-century origins of ‘global’ financial governance, to illustrate how both private institutions and state agencies were drawn towards the international level to manage what became in effect a global financial system based around the operation of the international gold standard. The second section canvasses what I call the ‘long’ 20th century, a period dominated in turn by efforts to re-establish the conditions for global finance after the disaster of World War I, then to contain global finance after World War II and finally during the last decades of the century to internationalize
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the institutional pillars of financial governance to allow for a genuinely global financial system
to emerge. The third section outlines the current set of arrangements within which most of the
issues associated with financial governance will be addressed over the foreseeable future. Finally,
a short conclusion reconnects these arrangements and their associated challenges to the broader
puzzle of global economic governance canvassed in the Handbook’s introduction.

The 19th-century origins of ‘global’ financial governance

Histories of global finance most often revolve around one or more of three important sets of
institutions: stock exchanges and/or capital markets (Riley 1980; Neal 1990; Eichengreen
2008), banks (Ehrenberg 1928/63; Feis 1930/64; Börn 1977/83) or central banks (Brown 1940;
Dickson 1967; Ahamed 2009). For our purposes it is the latter two sets of institutions that are
the key to considering the global origins of financial governance. And here it is crucial to
recognize that two developments above all stand out: (1) the growing international activities of
financial institutions; and (2) the national origins of efforts to control, oversee and/or support
these activities. It is from the confluence of these two trajectories that the earliest webs of global
financial governance were woven.

The modern history of international financial transactions and the institutions that conduct
these transactions initially paralleled the organization of trade in the early modern era. Trade
required financing and, in the efforts to organize the necessary credit to undertake trade, some
merchants began to specialize in handling the bills of exchange and letters of credit that allowed
others to pay for the goods that they purchased, moved and then sold. Such activities had been
a staple of medieval trade also, and were evident in the operation of the great fairs that peppered
the economic landscape of the time where debt was raised and settled with credit instruments
denominated in internationally traded currencies (Braudel 1982; Pirenne 1933/37). Out of this
milieu arose more specialized groupings, whose origins were almost always familial in scope and
whose sole focus eventually became the lending of money to merchants and of course to nobles
and sovereigns. Italian families were particularly dominant during the early modern period,
although German, French and ultimately English family-based institutions also participated.
What emerged out of this period was a network of family banking dynasties that, through their
close interactions, formed a nascent European financial system by which credit was mobilized,
allocated and distributed as need and opportunity dictated. It was a system built almost entirely
by private actors around a kind of code of conduct that relied upon personal integrity and
honour as the lodestone of behaviour.

Even though this nascent system was very much an elite affair—credit did not spread to the
working masses until the 1920s—it’s code was recognizable in the breach, as for example when the
South Seas and Mississippi Bubbles hit the English and French systems in the early 18th
century. In both cases, companies that were organized to help pay off sovereign debt in
exchange for overseas trading monopolies ended up pushing the creation of credit to support
new shareholders beyond a sustainable limit, resulting in financial collapses that wreaked havoc
on their respective economies (Kindleberger 1993). While the history of finance is replete with
episodes involving upstart organizations such as the South Seas and Mississippi Companies, over
time a surprisingly small number of family-based firms came to dominate the relatively rarefied
world of global finance. It is this small network of banking dynasties that Karl Polanyi identified
as haute finance in his classic work on the transition from the gold standard era to what became
known as the Bretton Woods system (Polanyi 1944/57).

Haute finance refers to the group of institutions that comprised the heart of the global financial
system during the 19th century. This system was centred on London’s financial district, but
reached out to envelop a series of secondary financial centres in Paris, Amsterdam, Berlin and eventually New York. These financial centres were important because they acted as the clearing places for mobile money and credit, which, no matter where it was earned and accumulated, almost inevitably ended up in a financial institution of some type. *Haute finance* as a group acted as the gatekeeper to these accumulated savings; they directed it towards suitable investments or steered those in need of it to its source. Cities came to be the natural home to *haute finance* because cities were what one scholar has identified as ‘information-exchanges’, namely places where the requisite knowledge about how to put capital to work most effectively came to be located (Smith 1984).

By the close of the 19th century, a handful of privately held, family-based institutions exercised paramount control over the international movement of capital. These included the Rothschilds and Barings in London; Lazard in Paris; Hope & Co. in Amsterdam; and Bleichröder and Mendelssohn in Berlin (Germain 1997). They all had well established reputations as reliable access points to mobile capital and worked with one another to ensure the smooth execution of cross-border transactions. In addition, by this time they had also struck up close working relationships with central banks, which were state-supported institutions that had spread throughout Europe over the 19th century to become important anchor institutions for national financial and monetary systems.

Originally, central banks were almost totally concerned with the monetary and financial side of their own domestic economies, including the funding of governments (Goodhart 1995). They were also uniquely open to private influence, despite their state-sanctioned responsibilities. The archetype here might be the Bank of England, which although not the world’s oldest central bank (that distinction belongs to Sweden’s Riksbank), was conceived and organized as a private corporation with both public and private interests. The Bank of England did not become a state organ until it was nationalized in 1946.

If one aspect of financial governance during the 19th century was the emergence of a self-generated code of conduct among bankers, its flip side was the parallel development of a deepening relationship between *haute finance* and central banks. During this period central banks were mainly concerned with the use of their own national currencies within their economies and with ensuring that the movement of capital into and out of their economies did not disrupt their currencies or imperil their leading financial institutions. In this sense they were focused on what we would today call domestic affairs, even if such affairs could easily be threatened by events in other lands. This domestic orientation was reinforced by the ownership structure of *haute finance*, which for the most part was capitalized through partnerships based within their home country.

However, such an orientation did not prevent a certain amount of co-operation among central banks from developing, especially in terms of efforts to support the operation of the international gold standard. Central bank co-operation tended to occur for two kinds of reasons. First, it might occur at moments of financial panic, when individual institutions came under threat of failure, which might in turn affect the commitment of that country to the gold standard. Second, it might occur at moments when large sums of money needed to be raised and transferred to pay a war indemnity. An example of the former was the support provided by the Banque de France (and other central banks such as the State Bank of Russia) to the Bank of England during the Baring Crisis of 1890, while an example of the latter was the support provided by the Bank of England to the Banque de France to facilitate the indemnity of 1871–73 that followed Prussia’s victory over France in the war of 1870 (Flandreau 1997; Kindleberger 1993). One scholar, Barry Eichengreen, suggests that the robustness of the pre-1914 international gold standard was indelibly linked to ongoing and robust central bank co-operation (Eichengreen 1992).
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Central bank co-operation, secured by the concentrated organization of the world’s monetary and financial system around haute finance, constitutes the most important legacy of ‘global’ financial governance bequeathed to us by the 19th century (Eichengreen 1992; Germain 1997; Langley 2002). Such governance was focused primarily on lender-of-last-resort actions and, secondarily, on maintaining the smooth flow of financial resources across borders if they were to come under threat. And while there is a scholarly debate about the efficacy of this essentially private form of governance, there can be no doubt that it formed the essential bedrock upon which later attempts to extend and entrench global governance were built.

The long 20th century: from the tumultuous 1920s to the globalized 1990s

The advent of World War I cut a swath through haute finance by severing the networks that had enabled financial resources to cross borders, as none of the principal belligerents allowed money to flow to their enemies. Governments instead inserted themselves into these circuits of capital to ensure that war efforts would be financed by any means necessary. Governments formalized their relationships with central banks and worked much more closely with them, and took on the responsibility for organizing war-time production. The end result was that governments acquired a much-enhanced capacity to manage and regulate the economic affairs of their countries. This was most evident in Britain and the United States of America (USA), but France and Germany also took unprecedented steps to subordinate their economies (and their monetary systems) to the exigencies of war (Eichengreen 1992). These governments developed tools to better control the external value of their currencies and to help determine the scale of cross-border financial transactions. Inevitably, expectations were raised about the degree to which government could and/or should participate in the organization of economic life, and state institutions began to evolve in line with these expectations.

Thus it was that, at the end of the war, it fell to the governments of the victorious powers to re-establish the working conditions for a viable international monetary and financial system. The problems that these allies faced were three-fold: they needed to re-establish some kind of international system to exchange their currencies with one another (and, in the case of new Central and Eastern European countries, to create usable currencies from scratch); they needed to re-establish the networks that had made the flow of capital across borders possible; and they needed to address the question of how to make the war reparations imposed upon Germany workable, while also not letting the huge sums owed among themselves for war debt to destabilize their own fragile economies. These problems produced the first genuine attempt to erect what today we would call an international financial architecture (Kindleberger 1973; Meyer 1970; MacNeil 1986).

This architecture was organized partly around the work of formal international organizations, partly around a reinvigorated network of central banks and partly also around the efforts of haute finance. More specifically, we might say that the interwar period saw the first official government efforts to establish a permanent basis for some form of ‘global’ financial governance. The main mechanisms of governance included the economic committees of the League of Nations that were involved in establishing the currencies of the new nations of Eastern and Central Europe; the Office of the Agent General for Reparations Payments, established in 1924 by the Dawes Plan to oversee German reparations; a reinvigorated central banking network that facilitated co-operation among the central banks of Britain, France, the USA and eventually Germany in the late 1920s; and haute finance, which was for a short while able to direct capital from the American financial markets to Europe, and especially to Germany. Together, these efforts produced a short period of monetary and financial stability from 1925 through to about
Origins and development of global financial governance

1931, during which time currencies once again became linked to gold and freely convertible, cross-border capital flows resumed, and international trade flourished (Eichengreen 1992; Pauly 1997; Ahamed 2009).

The significance of this period of financial governance lies in two areas. First, it built upon the domestic basis of financial governance established during the 19th century by adding to it a clear international component. Governments and central banks convened a number of high-profile international conferences to prepare for a return to the international gold standard and to seek international solutions to problems that plagued them all. For a variety of reasons these conferences failed to reach a wide-spread consensus, yet they should be seen as necessary precursors to the more successful 1944 Bretton Woods conference that outlined at least some of the working foundations for the post-war international monetary system. Second, like later governance mechanisms, the institutional pillars of the interwar period recognized the involvement of both public and private forms of authority. Haute finance, governments and the hybrid authorities that were that era’s central banks were all constituent elements of the decision-making mechanisms of this architecture. ‘Global’ financial governance, like its domestic counterpart, relied upon a fusion of public and private authority for its operational effectiveness (Germain 2010).

As all histories of this period recount, however, the world’s monetary and financial systems broke down under the weight of the global economic crisis of the 1930s. The international efforts described above, while successful for a short period, unravelled after 1931, when Britain abandoned the gold peg for its currency. International capital and trade flows collapsed and economic crisis enveloped much of the world. Financial governance as an enterprise returned to its domestic focus, with governments wresting primary control over haute finance from central banks. The economic organization of the world retreated from a global to a narrower regional format, with economic blocs forming around either formerly dominant currencies such as the pound sterling or the American dollar, or around political poles of power such as Germany, Japan and France (which used its currency’s anchor to gold to extend its political influence). As a result, when war broke out in 1939, there was virtually no impact on the ‘international’ element of the world’s monetary and financial system, for the simple reason that this element had already been effectively neutralized. It would fall to whoever triumphed in World War II to once again try to re-establish a viable international monetary and financial system.

And indeed, the Bretton Woods system, the term most often used to describe the world’s monetary and financial system between 1945 and about 1975, built directly upon many of the lessons derived from the interwar period (Van Dormael 1978). Governments built upon their experience of controlling the use of their currencies and of more strictly regulating haute finance to construct a global monetary and financial system that would be more receptive to the perceived needs of government. Currencies were made convertible by being linked not to gold but to the US dollar, and interest rates were set by government agencies to support levels of domestic economic activity rather than, as under the old international gold standard, to support the value of a currency. Controls were placed on the amount of capital that could be raised for international use in many countries, and foreign direct investment was everywhere subject to state scrutiny. The upshot was a global monetary and financial system that was subject to much stricter government oversight and which was made to operate more clearly as a support system for the global system of trade and production (Block 1977; Helleiner 1994; Andrews 2008).

What did the global architecture of financial governance look like during the Bretton Woods period? Initially it had two main features: (1) a division of labour between domestic and international activities that favoured domestic agencies; and (2) a heavy reliance on public regulatory agencies to set the basic parameters of activity for haute finance and their new challengers,
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especially big commercial banks. During the first years of Bretton Woods, the most important
governance agencies by far were a small set of officials occupying offices in the key central
banks and finance ministries of the richest industrialized countries—those that eventually
became the core economies of the G-7. And among these, the principal architects of global
financial governance were American officials at the Federal Reserve Board (together with the
New York Federal Reserve Bank) and the US Treasury, and their British counterparts at the
Bank of England and the Exchequer. It was these officials who between 1945 and the late
1950s made key decisions about interest rates, currency convertibility (the bedrock of the gold
exchange system established at Bretton Woods) and controls on international capital flows to
support the reconstruction and development of war-torn economies.

However, as the 1960s progressed, a number of developments undermined both the
domestic anchors of Bretton Woods and the capacity of government agencies to retain a vice-
grip over the operation of their financial systems. Some of these developments pushed central
banks and other regulatory agencies to expand their international networks to cope with the
increasing scope of cross-border capital flows and the growth of the international activities of
financial institutions. Key here was the growth of so-called offshore currency markets—or
‘euro-currency’ markets as they were initially called—together with a growing balance of pay-
ments deficit on the part of the American economy (Burn 2006). With dollars flowing out of
the American economy to pay for imports, capital investments abroad and military expenditures,
the fixed exchange rate system established after World War II came under pressure as the
global supply of American dollars swelled. International monetary co-operation through central
banks and other public agencies became a necessary first line of defence to support the value of
the dollar (Cooper 1968; Andrews 2008, ch. 6).

As the controls on capital flows became less effective, new networks of financial institutions
emerged to mobilize and tap into internationally mobile capital. Whereas haute finance domi-
nated the organization of cross-border capital flows up to about 1930, full service banks took
their place during the Bretton Woods period. Initially capital flowed from the USA to Europe
via the Marshall Plan and other government-sponsored initiatives, but over time this public
component shrank and commercial banks replaced them. By the time American President
Richard Nixon ended the official link between gold and the US dollar in 1971, over half of all
cross-border capital flows originated in the private sector, spanning commercial banks, the old
haute finance and other newer more specialized financial institutions (Germain 1997). The public
character of the early Bretton Woods financial system gave way to one much more influenced
by private forms of authority.

When Nixon officially closed the gold window, many warned that the move towards a
completely flexible exchange rate system would spell monetary chaos. Less remarked upon at
the time was a concomitant move—led by Nixon’s successor President Gerald Ford—to relax
existing controls on the cross-border movement of capital (Helleiner 1994). It was Ford, followed
by British Prime Minister Margaret Thatcher shortly after her 1979 election, who began the
process of liberalizing the world’s financial markets. Capital account liberalization, together with the
move to floating exchange rates, generated a hard demand for an enhanced degree of interna-
tional co-operation to contain the consequences of these developments. Within a few short
years, a number of spectacular (for the time) banking failures confirmed the dangers of combining
financial liberalization with currency volatility, and the result was a renewed push for central
banks and financial regulators from G-10 countries to step up their efforts to work together.6

Beginning in the mid-1970s and extending through to the end of the 20th century, financial
governance extended its international component, became more complex as different elements
of the global financial system were drawn into its purview and returned more fully to its
origina hybrid blend of public and private authority. The growing international component paralleled the increasing globalization of financial markets and was driven in spurts by a series of international financial crises. With the exponential growth of foreign exchange market activity and cross-border financial transactions, it became a necessity for monetary officials to liaise actively with their counterparts simply to keep abreast of financial developments and be prepared to act if necessary. Initially these liaisons were channelled through the Bank for International Settlements (BIS), the Depression era creation of the Young Plan, which escaped mothballing after World War II and then served as a central co-ordinating venue for central bankers to exchange information and forge solid working relationships (Toniolo 2005). It was not the BIS itself that was critical here; rather, it was that the BIS served as the meeting place for a number of other co-ordinating actions that received their impetus from domestic agencies such as the Fed or Bank of England. For example, the Basel Committee on Banking Supervision (BCBS)—established by the G-10 in 1974 to examine the supervisory practices of banking regulators—although headquartered at the BIS, is nevertheless very much a creature of its constituent central banks rather than the BIS (Wood 2005). One can make a similar argument regarding the Financial Stability Board, a more recent Basel-based co-ordinating mechanism for developing regulatory benchmarks to ensure stability in the global financial system. Eric Helleiner (1994) gets it about right when he identifies a ‘Basel regime’ as central to contemporary global financial governance, precisely because he is careful to delineate a cluster of agencies that utilizes the BIS for its ‘good offices’, rather than portraying BIS officials themselves as some kind of financial kingpin.

This increased internationalization is also evident across the operational spectrum of the global financial system. As the organization of global finance has become more complex, with new institutions engaging in innovative practices that move capital in different forms across borders, the regulative and governance needs of the world’s financial system have grown. Where once global financial regulation largely meant watching over the international activities of banks, today insurance companies, private equity firms, hedge funds, money market funds, investment banks, commercial banks, mortgage providers and more are all critical participants in global finance. They all require some degree of oversight for the purposes of safeguarding financial stability. Within countries, very often different sectors of the financial system have acquired their own regulatory apparatus, and this diversity of regulatory institutions has spilled over to the international level. As a counterpart to the BCBS, therefore, we now have organizations that allow for insurance supervisors (IAIS), stock market regulators (IOSCO), accountants (IASB) and participants in swaps and derivatives markets (ISDA) among others to cooperate in the sharing of information and in the development of standards and codes to guide their behaviour.

As global finance and the infrastructure of its governance have become more complex, many of the institutions that are involved in governing financial transactions have evolved into a hybrid form of authority, driven by the particular way in which public and private financial institutions have become involved in international decision-making. Central banks and their international organization, the BIS, are one example of this. Most central banks, although mandated and sanctioned by their governments, are statutorily independent in their own right. This independence is also present among a small but growing number of state regulatory institutions. While central banks are accountable to their governments, they are only subject to what might be seen to be indirect democratic oversight. At best, they might be said to represent a quasi-public form of authority.

The growing hybridity of authority within global financial governance is evident in other ways as well. Some of the institutions involved in financial governance generate rules and principles that are derived from professional standards and benchmarks. The best example here
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is the International Accounting Standards Board (IASB), headquartered in London and made up of independent experts from the world of accounting who develop the financial reporting standards used by markets (and governments) to measure the different ways that corporations present the value of their assets and liabilities (Büthe and Mattli 2011). The key point here is not that private forms of authority alone set the rules of accounting in a unilateral manner. Rather, a set of experts largely based in the private sector have taken a leading role in developing standards that are in turn used by governments as they regulate financial activities. As Braithwaite and Drahos (2000) illustrate in their magisterial and comprehensive overview of the globalization of rule-making in the global economy, this hybrid form of authority has come to define the structure of global business regulation today, including global finance.

A final example of this hybrid form of authority can be seen in the role played by private sector institutions in financial governance. For example, although not formal international institutions at all, credit rating agencies such as Moody’s and Standard & Poor’s have assumed a growing and government-sanctioned role in some of the regulatory assessments carried out by public agencies (Sinclair 2005). These private, market-based forms of authority undertake activities that are driven by the needs of the private sector—in this case the provision of ratings on the issuance of debt instruments—but yet that are included (in different ways in different countries, to be sure) among the standard metrics used by public authorities to assess the soundness of internationally active financial institutions. For example, Basel II, the framework of standards developed by the BCBS in the early years of the 21st century to assess the soundness of banks, included in one of its evaluative pillars the ratings issued by a handful of leading credit rating agencies (Rethel and Sinclair 2012). Other examples of private forms of authority influencing or attempting to influence the development of international regulatory standards include the role played by the Group of 30 in derivatives regulation and the Institute for International Finance (IIF) over the inclusion of internal risk assessment models as part of the Basel II criteria. And while not all of these endeavours have been successful from the point of view of private sector authorities, it cannot be disputed that the resulting regulatory structure is a hybrid product of the interactions of private and public forms of authority. (For further details on the phenomenon of private sector involvement in global financial governance during the contemporary period, see Tsingou (2007); Sinclair (2005); and Young (2012).)

By the close of the 20th century, therefore, the infrastructure and formal organization of global financial governance was set. It had national political components in the form of powerful states and their coalitions, from which emanated pressure to continue liberalization efforts directed towards national financial systems. There was a complex network of formal and informal international institutions that supported liberalization efforts, while at the same time searching for ways to reduce the vulnerabilities that liberalization inevitably produced, including especially the often severe effects of financial crises. The sheer growth of financial markets and with them financial institutions of many types further generated a push by private sector authorities to be more fully involved in developing financial regulations at all levels. And, in a novel development, organizations within civil society also became for the first time more vocal in their evaluations of and contributions to debates over financial governance, especially in light of the financial crises in Asia in 1997–98 and in North America and Europe in 2007–08. These elements are the focus of the next section.

The 21st-century elements of global financial governance

From the vantage point of the second decade of the 21st century, we can point to four main pillars that constitute the principal architectural struts of global financial governance. These
pillars in turn rest upon and reflect the economic, social and political terrain that is canvassed in the introduction to this Handbook. Furthermore, this terrain encompasses a diverse set of actors, a changing hierarchy of power, contestation over both technical ideas and their broader socio-political paradigms, and new formulations of issues that combine the interests of long-established agents in new and challenging ways.

These elements of global financial governance can be described as follows:

1) **Powerful states and their coalitions: public authority**

The leading public forms of authority involved in financial governance remain states and the agencies directly accountable to governments that regulate financial institutions. But, as many critics note, not all states are equal, and in the game of financial governance only a handful of states (together with their regulatory agencies) are at the apex of power. These tier 1 states include those that have the largest, most mature and most internationally integrated or oriented financial systems: the USA, Great Britain, Germany, France and, more ambiguously, Japan. These states are important because between them they are home to the bulk of the largest internationally active financial institutions, and therefore the regulations that they develop and apply have the widest global impact and scope.

There is a second tier of powerful states that comprises two tranches: (1) smaller advanced industrialized countries with a long history of financial openness and international activity, such as Canada, Switzerland, the Netherlands and Sweden; and (2) fast-growing emerging market economies with financial systems that are increasingly integrated with the global financial system, such as China, Brazil, Hong Kong, Singapore and South Africa. Russia and India are often also included here, but the unevenness of their financial system’s linkages with the global financial system suggests a cautious approach to their global influence. Together these tier 2 states are important because on one hand they provide coalition partners for the tier 1 states, while on the other hand they represent the possibility, especially pronounced with respect to the emerging market economies, of developing alternative regulatory pathways to consider pursuing in some circumstances.

The fact that public authority is organized in a pattern of interstate arrangements constitutes the international political dimension of global financial governance. Coalitions can crystallize and/or shift according to both the alignment of economic and/or political interests, such as when the newly upgraded leaders G-20 (Group of Twenty) met in Washington and London in late 2008 and early 2009 to consider the kind of international response warranted by the global financial crisis (Helleiner and Pagliari 2009). An earlier example is the alignment of interstate interests between the USA and Great Britain in the 1980s that paved the way for the first Basel Capital Accord (Kapstein 1994). The point to reinforce here is that public authority in the form of states and their relations is a major pillar driving global financial governance (Porter 2003).

2) **International institutions: a fusion of public and private authority**

A second major pillar for global financial governance is international institutions, which are the traditional focus of scholarly analysis. As described in the previous section, there is a complex network of these institutions involved in developing and co-ordinating international regulatory initiatives, including the Basel-based organizations such as the FSB, the BCBS and IAIS, as well as IOSCO, IASB and the Financial Action Task Force (FATF) among others. But of course there are much longer established international financial institutions that also have a major stake in the global financial architecture, namely the International Monetary Fund (IMF), the World
Bank, the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO).

While the OECD and WTO are not extensively engaged in global financial governance, they are involved in helping to develop the rules that pertain to some cross-border flows of capital, specifically to foreign direct investments and to those flows associated with capital account openness. For example, the OECD’s Committee on Capital Movements and Invisible Transactions has had a long involvement in efforts to liberalize the capital accounts of its members, with the signal effect of helping to spread the norm of capital account liberalization among the world’s richest economies, even if on occasion it has overstepped itself as with the failure in 1998 of the negotiations for the Multilateral Agreement on Investment (Abdelal 2007). And the WTO, although principally concerned with the rules governing international trade, is also the main international negotiating forum to agree to rules governing cross-border investments. This occurs mainly under the rubric of considering global rules for trade-related investment measures, or TRIMs (Porter 2005; May 2010). It is important to note, however, that both the OECD and the WTO act as venues where states can work to develop global rules, rather than as agents in their own right.

In contrast, both the World Bank and IMF play a greater role in the global financial architecture, often with agendas that are more clearly identified with these institutions as relatively autonomous forms of agency. Of these two institutions, the role of the Bank is more constrained. The vast bulk of its resources are project-related and devoted to developing either economic infrastructure or state capacity in poor and middle-income countries. This focus limits the Bank’s involvement in key sites of decision-making for the global financial system as a whole, even though it does participate in some decision-making fora, such as the FSB and the new leaders G-20.

There is no such ambiguity about the centrality of the IMF within the global financial architecture. The IMF has found an important new global role over the past decade by lending fewer tangible resources but increasing its provision of knowledge or reputational resources (Broome 2010; Moschella 2010; but see Smith 2008 on this role for the World Bank). It participates in many of the more specialized network organizations described in the previous section, as well as continuing to devise and/or support national recovery programmes that governments in crisis are required to develop if they are to receive any assistance from the international community. The IMF is also fully involved in assessing the extent to which countries have successfully implemented the many initiatives developed by more specialized global regulatory agencies. The IMF has become over the past decade a critical evaluation arm of global financial governance: if not quite the world’s financial policeman, then certainly its chief surveillance officer (Davies and Green 2008; Porter 2005).

3) Markets and private sector agents: private authority

The question of how a complex, global and integrated financial system gets governed cannot be satisfactorily answered solely with reference to what states and international institutions do. Global financial markets and cross-border financial transactions have grown so significantly over the past 40 years that inevitably private sector authorities have been drawn into the organization of financial governance. This has occurred at all levels of governance, from domestic to the regional and global levels. In many ways this is a return to the modalities of financial governance during the late 19th century, when private authority constituted the heart of whatever financial governance actually existed. It is also a key driver of what was earlier identified as a unique hybrid form of governance authority, a public/private ‘condominium’ as one scholar has identified it (Underhill 2000).
To argue that markets and private sector agents—private authority in short—constitute an important element or pillar of global financial governance is to recognize the multiple ways in which an essentially private form of economic organization shapes the possibilities of governance. This has both a negative and a positive correlation. On the negative side, the organization of markets places important parameters around what kind of regulations are possible and the mechanisms through which they can work. The fact, for example, that there are thousands of banks domiciled in the USA but far fewer in Canada or Great Britain has important regulatory implications, for example by making the centrality of competition policy as a mechanism of governance work very differently in each country. One of the starkest differences between the financial world of the 19th century and that of the 21st century lies with the sheer number of large financial institutions active in each: a handful of haute finance dominated the 19th century, while no such similar concentration is at work today.

When the size of financial markets is considered alongside the significant number of large, active institutions, the practical implication for financial governance is that regulation, which relies predominantly on the ability of officials to oversee all manner of financial activity, is simply not a viable or sustainable option. Regulators have thus turned to using the competitive aspects of markets as one part of their toolkit. There are many critics of this approach, of course, but nevertheless most officials involved in designing global regulatory standards see little option but to employ the market as part of their regulatory armoury (Crockett 1997). Such was the thinking, for example, behind including market disclosure requirements as part of the third pillar of the Basel II accord (King and Sinclair 2003).

The private sector institutions that make up the market, or rather a specific sub-section of them, also now have a large role in determining the final shape of almost all financial regulations. Whether at the national level, as with the drafting of the Dodd-Frank legislation in the USA, or at the international level, with the drafting of successive versions of the Basel capital accords, private sector agents and their associations play an important part in developing all manner of international financial regulations. In the industrialized world, major regulatory developments do not occur without input from relevant stakeholders, and these stakeholders often have two opportunities to provide input and feedback on rule changes: once as an individual firm, if they are large enough; and a second chance through their membership in peak associations or sometimes also self-appointed lobby groups such as the IIF. Global financial governance has built into its decision-making apparatus many points at which private authority can weigh in as regulations are developed. Such consultative input forms the basis of the hybrid form of authority that is now at work in global financial governance.

4) Inter-subjective ideas and the organization of civil society

Whereas the first three pillars of global financial governance comprise sets of discreet agents that combine in specific ways, the final pillar is more amorphous and conjunctural in nature, but no less tangible in status. This is the intellectual terrain of inter-subjective ideas and the broad social formations within civil society through which these ideas are advanced and contested. One striking development in global financial governance over the past 20 years is the manner in which organizations and movements within civil society—often articulated as non-governmental organizations (NGOs) and other civil society organizations (CSOs)—are giving voice to concerns to which regulators and those charged more generally with upholding financial stability now feel compelled to respond. These concerns are often linked to the consequences for poverty alleviation and development that particular financial regulations entail. To return to the Basel II example, many inside and outside academia pointed to the adverse effects
that aspects of this accord would have on banks from developing countries (Classens and Underhill 2010). These concerns and others have been taken up by many NGOs and CSOs as they have engaged with different elements of the global financial architecture. While their direct impact on the direction of global financial regulation is not always easy to measure, few doubt that NGOs and CSOs are now a legitimate part of the broader debate on financial governance (Germain and Kenny 2005; O’Brien et al. 2000; Scholte and Schnabel 2002).

The opening of the debate about financial governance to include civil society-based organizations demonstrates the extent to which the formerly technocratic aspect of financial governance is now being challenged. Historically, debates about financial governance and the institutions active in financial governance have been highly restrictive, both in terms of who does what and in terms of who is legitimately enabled to pronounce on financial affairs. Effectively, those with the authority to speak about finance have been few in number and for the most part tightly linked to either private financial interests or to those directly involved in regulating the financial system in the public interest. The push by NGOs and CSOs to be more actively engaged with such debates not only illustrates how the foundations of global financial governance have evolved, it also suggests that the intellectual terrain over which the debate about financial governance has occurred is shifting (Armijio 2002).

One example of this ideational shift is the idea of liberalization, which was identified above as a key narrative thread of the history of global finance since the end of Bretton Woods. An unremitting commitment to liberalization was evident in the approach taken by international financial institutions such as the IMF, BCBS, OECD and others towards capital account transactions, currency convertibility and foreign investments, as well as certain elements of financial stability including the regulation of institutions through market-based mechanisms such as disclosure requirements and the use of internal risk assessment models. In general, reducing non-economic barriers to the movement of capital, prioritizing economic inputs into the development of financial regulations and enhancing the competitive environment of financial systems were all seen to be key pillars of sound, stable financial systems. Following the work of Robert W. Cox (1987), we might describe this as an inter-subjective ideational framework, one that was widely shared among all the key actors during this period.

Since the 2007–08 financial crisis, this commitment to liberalization has been recast to place more emphasis on the economic vulnerabilities that result from its pursuit. Most important perhaps has been the IMF’s reappraisal of the benefits of capital account liberalization and the role that can be played by capital controls. The IMF no longer advocates capital account liberalization as a necessary condition of its programmes, even if the ideal end-point of financial system evolution should be a fully open capital account and a genuinely competitive financial system. Equally significant is the endorsement by the IMF of a more proactive management of capital inflows in order to protect against adverse currency volatility under certain conditions. The point here is that the inter-subjective consensus evident within the institutions of global financial governance around the idea of liberalization has been relaxed (Chwieroth 2010; Moschella 2010).

Of course, simply because NGOs and CSOs are now more engaged in debates about global financial governance and the inter-subjective consensus underpinning dominant norms and rules associated with such governance are evolving does not mean that the fundamental basis of social relations around which the world’s monetary and financial systems are organized has been altered. As many analysts of global finance from the tradition of political economy have emphasized, the basic outline of the capitalist market economy—its global scope and deep organizational structure—remains intact. That is to say, the class structure upon which the global financial architecture rests still retains its essential shape despite the severity of the
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2007–08 financial crisis (Panitch and Gindin 2012; Rupert 2005; Soederberg 2006). Thus, even as the debates, agents and institutions involved in global financial governance have evolved over the past two decades, this has occurred within a socio-political context—a global structure of accumulation—that is itself robust and enduring.

Conclusion

The global history of financial governance can be traced back to the late 19th century and involves in equal parts the evolution of financial institutions and their activities, together with the development of relations among state-led regulatory institutions such as central banks. As the 20th century progressed, this history also encompassed a growing international element composed of the relations among central banks and other regulatory agencies, along with the creation of specialized international financial institutions (whether more or less formally organized) designed to address problems of co-ordination and communication among leading financial powers. If, as the introduction to this Handbook suggests, global economic governance is concerned with developing an international rules-based framework within which co-ordination problems can be addressed, then this chapter confirms that much of the global history of financial governance can be usefully viewed through this analytical prism.

We can also use the criteria outlined in the Handbook’s introduction to provide a brief assessment of the ‘success’ of the current set of global financial governance arrangements, so long as our understanding of such success is historical and relative rather than categorical and absolute.9 The criteria against which we can assess the success of contemporary efforts at global financial governance include whether it has achieved the necessary level of political legitimacy, whether its institutional make-up has achieved the necessary resilience and adaptability to be successful and whether it has achieved an acceptable level of what might be termed effectiveness. And, while subsequent chapters will explore these criteria in more detail for specific global financial governance arrangements, overall a certain basic level of success should be recognized as having been achieved along all three criteria.

In terms of the question of political legitimacy, the global financial architecture recognizes the fundamental role of state sovereignty in the exercise of financial regulation. There are no supranational institutions involved in regulating financial institutions, and it is unlikely that any will be created in the near future. The closest supranational institution involved in financial governance today is the European Central Bank (ECB), which, however, has to work with member states of the eurozone in the development and implementation of its policies, which in any case only ‘apply’ to eurozone members. Neither the IMF nor BCBS, nor even the FSB can be considered supranational institutions, as all are very much open to pressure from their member states.

How does this strengthen the political legitimacy of the global financial architecture? It does so by forcing decisions over financial governance to work within the fundamental framework of interstate relations. And while many will decry this as antithetical to developing an integrated political basis for the world’s economic governance, in fact the need to work with the principle of political sovereignty is the starting point for developing a genuinely international decision-making framework, precisely because this recognizes and allows the interstate balance of power to function in an open and relatively transparent manner. It remains as difficult today to banish the operation of power from our analysis of global economic governance as it was during the interwar period, which scholars ranging from E.H. Carr to Barry Eichengreen have revealed so clearly (Carr 1946/1983; Eichengreen 1992). We should consider the recognition of sovereignty to be a signal strength of contemporary global financial governance, one which bestows on it a certain basic degree of political legitimacy when viewed from a systemic perspective.
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Does this achievement of a basic degree of political legitimacy also enable what global financial governance we have to be resilient and adaptable? In theory it should, since adaptability to change will inevitably be led by national authorities who are the financial equivalent of ‘first-responders’. In practice, however, the complexity of global financial governance arrangements, not to mention the intricate and interwoven nature of financial markets and institutions, suggest that, beyond the purview of the national economy, no set of governance arrangements can be sufficiently resilient and adaptive, simply because the global financial system itself is too large, integrated and complex to be ‘governed’ from any one point of authority. Instead, regulatory authorities at the national and global levels are effectively always playing catch-up to developments in financial markets and to the activities of financial institutions. They may be likened to military generals, who purportedly are always playing catch-up to developments in financial markets and the intensity of global governance arrangements. On this rudimentary basis, at least, we should recognize that global financial governance is an enduring element of the global financial system. Indeed, on most measures the world could not get along financially without it.

Nevertheless, a closer reading of the global history of financial governance does reveal that officials have indeed almost always used financial crises as opportunities to learn about new sorts of financial vulnerabilities, leading them to develop new and sometimes innovative regulatory institutions. This is how the BIS, IMF, BCBS and other institutions that constitute a significant element of global financial governance originated. So any assessment of its resilience and adaptability needs to recognize that global financial governance is an enduring element of the global financial system. Indeed, on most measures the world could not get along financially without it.

Finally, how effective is global financial governance? This is the trickiest measure of all, because the baseline criteria are impossible to agree. At one level, the history of global finance is replete with failures and collapses and crises; how could any assessment of the effectiveness of current global financial governance arrangements possibly yield a positive score? And yet, with only one exception—during the 1930s—did the world’s monetary and financial system retreat from whatever levels of integration it had achieved prior to the crisis. This historical fact alone should suggest that the baseline trend of financial governance is resolutely global in scope. However shaky, there appears to be a positive correlation between growth in the size of the global financial system and the intensity of global governance arrangements.

But our assessment here should also be mindful of the complexity of financial governance (at any level), and therefore it should include among its criteria a set of worst-case and best-case scenarios. This is because effectiveness is also about mitigating systemic harm and ensuring that whatever the state of the global financial system, there exists a political and institutional framework by which the disparate elements of such a system can continue to interact. On this score the structure of global financial governance—its architecture—has been modestly successful, except of course for the period of the 1930s. After each monetary or financial crisis of the post-1945 period, this structure has been extended and strengthened, either by including different sets of regulators or different sets of private financial institutions, or indeed entirely different sets of states. In other words, there has been a determination on the part of the major financial powers to ensure that an international framework exists as an indispensable component of the world’s monetary and financial systems. It is also significant that other actors within these systems have been ready to answer the call for closer involvement with the major powers and their associated global financial architecture. On this rudimentary basis, at least, we should recognize that the structure of global financial governance has achieved a modest degree of success.

The future of global economic governance in the domain of finance will build upon the historical developments canvassed in this chapter. This record has its share of triumphs and disasters, but the overall trajectory points to more and continuous involvement of governments and their regulatory agencies in the organization and delivery of financial governance at the
global level. Also involved will be international institutions of various kinds, along with private sector actors and increasingly also civil society organizations. The ideational terrain is shifting, to be sure, but a significant and enduring element of this terrain will be a push for financial liberalization within the context of unremitting economic globalization. Financial crises of various kinds will undoubtedly also be a part of this future, as will be the responses to it, which will inevitably take global financial governance to a higher and more extensive level. In this way, the past—as always—will be prologue to the future.

Notes

1 This definition follows the classic formulation of political economy articulated by Robert Gilpin (1987, 8): ‘The parallel existence and mutual interaction of “state” and “market” in the modern world create “political economy”; without both state and market there would be no political economy’. While there are many points of contention with this definition, it is the conventional understanding of the term. See Cohen (2008) and Phillips and Weaver (2010) for discussion of this definition within the context of the discipline of international political economy (IPE).

2 While all central banks were created to perform certain functions for government, they were often characterized by private ownership and were subject to very limited direct influence from government. They were in effect quasi-public entities that were integrated with private forms of authority. See, for example, Deane and Pringle (1994).

3 Interestingly, national currencies themselves are largely a 19th-century phenomenon. Prior to this the circulation of currencies was largely disassociated from national boundaries (Gilbert and Helleiner 1999).

4 Some leading haute finance, however, were more international in their capital structure, often for reasons associated with family connections. For example, the Rothschilds banks across Europe had an unusual multinational capital structure, while J.P. Morgan had a significant partnership stake in the London investment bank J.S. Morgan (Ferguson 1999; Carosso 1987).

5 The Federal Reserve System is composed of 12 regional banks (in which the New York Federal Reserve Bank is primus inter pares) and the Federal Reserve Board, or Fed, which sits in Washington and reports to Congress. Historically it has been the New York Federal Reserve Bank that has conducted the international activities of the Fed. The main operational arm of the Fed is the Federal Open Market Committee (FOMC), which is composed of the Board of Governors of the Fed, the President of the New York Federal Reserve Bank, plus the Presidents of four other Federal Reserve Banks.

6 This period is canvassed in more detail in Germain (2010); Wood (2005); and Andrews (2008). The G-10 grouping of countries was initially formed to help protect the US dollar when it came under pressure in the early 1960s. This group of advanced industrialized nations pooled some of their central bank resources to intervene in foreign exchange markets, and thereafter their monetary and financial officials worked together in several international fora to stabilize the world’s monetary and financial system. The G-10 includes the G-7 countries (USA, Britain, France, Germany, Japan, Italy and Canada) plus the Netherlands, Belgium, Sweden and Switzerland.

7 Along with the G-20, it should also be recognized that the politics of interstate relations plays out in other coalitional groupings such as the G-7 and G-10, as well as the recently developed BRICS grouping of countries comprising Brazil, Russia, India, China and South Africa.

8 There are a number of other organizations based at the BIS in Basel that are active in the global financial architecture, including the Committee on Global Financial Stability (CGFS), the Committee on Payments and Settlement Systems (CPSS) and the Joint Forum. For a contemporary overview of this network see Davies and Green (2008).

9 That is to say, we will assess the success or failure of global financial governance against the standards of the era in which it occurs rather than against some kind of transhistorical standard.

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The G-20 and global financial regulation

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Introduction

In the wake of the 2008 global financial crisis, the G-20 established itself as the pivotal forum for collective international response to the crisis. The apparent centrality of the G-20 in preventing global economic collapse has thrown the spotlight onto this relatively new player in global economic governance, and has led to debate about both its legitimacy and effectiveness. Many have praised the G-20 for quick and robust action in the wake of the crisis (Cooper and Helleiner 2010; Heinbecker 2011; Smith 2011). In this view, the G-20 has emerged as a powerful player, more truly representative of developed and emerging economies than other institutions, and the best hope for global financial governance (Smith 2011; Carin et al. 2010). Others, in contrast, argue that the G-20 has done far too little to effectively address the crisis and, in addition, suffers from a range of legitimacy problems, including its exclusive membership, informality and lack of transparency and accountability (Vestergaard and Wade 2012). In this critical view, the G-20 is an elite club promoting the interests of powerful market economies and impeding deep regulatory reform that is needed to prevent future crises.

Indeed, what is clear to both sides of the debate is that the G-20 offers a different model of governance than the traditional formal intergovernmental organizations (IGOs) established by treaty after World War II, such as the International Monetary Fund (IMF) and the World Bank. As the balance of power in the international system shifts toward emerging economies and rising non-Western powers, these post-World War II institutions have become outdated, no longer distributing authority to those actors most important for maintaining order and stability. Despite calls for institutional reform, these institutions have remained largely recalcitrant and retain the main attributes they were created with in the 1940s. In the absence of true reform, new ad hoc and non-universal institutions are being created as alternative fora for global governance. In this sense, the G-20 may be symptomatic of an institutional transformation away from traditional, universal, state-based IGOs toward smaller and more flexible clubs of common interest (Drezner 2007; Viola 2008). In a multipolar world with lots of actor heterogeneity, powerful states may pursue ad hoc and non-universal groupings because they facilitate more effective policy co-ordination and consensus, and they mitigate fears of exploitation and redistribution. At the same time, their very exclusivity and informality create problems of legitimacy and authority.
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This chapter explores this debate by investigating the specific effectiveness of and legitimacy challenges to the G-20. The G-20 was critical in achieving a co-ordinated policy response from major economies in the immediate wake of the 2008–09 economic crisis. Nevertheless, its performance since then has left doubt about its commitment and capacity to midwife real governance reform. This chapter argues that the G-20’s ability to remain a powerful and constructive actor will depend on whether it is willing to undertake institutional adaptations and reforms to remedy key challenges to its efficacy and legitimacy.

The first section begins by explaining the origins of the G-20, which is itself the result of an institutional adaptation to economic crisis. The second section illuminates the institutional design and governance functions of the G-20, with a view to identifying where the main challenges to its effectiveness and legitimacy lie. This discussion narrows in on four sets of issues that affect both the G-20’s effectiveness and legitimacy: its membership, the scope of its agenda, its ability to achieve policy co-ordination and the nature of its institutional structure. The third section picks up on these four issues to analyse in what way they present challenges to the G-20, how the G-20 may have already begun addressing them and what further institutional innovations and adaptations are necessary.

The origins of the G-20: an institutional adaptation to crisis

The G-20 was created in 1999 by the G-7 as an institutional adaptation meant to address two challenges facing international financial regulation in the 1990s. First, and most immediately, the Asian financial crisis of 1997–99 made clear that, despite the growing sophistication of international financial institutions, governance bodies such as the IMF and G-7 failed to predict or prevent the crisis. The crisis revealed that these established institutions had a significant blind spot when it came to the systemic importance of a number of emerging economies. Those states most important for the Asian financial crisis were hardly represented in the international financial institutions, and not at all represented in the G-7. It became clear that effective and comprehensive global financial regulation would need systematically to include emerging economies.

The second, and more general, challenge of the late 1990s was the fact that the international financial regulation regime had grown significantly larger, more diffuse, and more complex over the previous two decades. No institution, including the G-7, had effective oversight over the burgeoning number of regulatory institutions. In addition to the Bank for International Settlements (BIS) and the IMF and World Bank, new actors included the Basel Committee on Banking Regulations and Supervisory Practices, the International Organization of Securities Commissions (IOSCO) and numerous other committees. These institutions were each producing large amounts of technical data on and analysis of global financial markets. They were beginning to reach agreement on best practices and formal standards, and to create instruments of implementation and oversight. Most notably among these are the Basel Committee’s capital adequacy standards and the IOSOC’s Objectives and Principles of Securities Regulations. But as these institutions became increasingly connected with national regulators and with one another in an informal way, it became clear that some systematic mechanism for co-ordinating between these bodies was necessary (Porter 2000, 9).

The lesson that states learned from these two challenges was that there was a need for a new institutional arrangement that would maintain a comprehensive view over international financial governance while also being inclusive of emerging economies. As a result, the G-7 created a new body, the G-20, which expanded the membership of the G-7 by including ‘systemically significant’ states, and whose purpose was to serve as an agenda-setting and oversight institution. The G-20 initially began as a technocratic body, composed of finance ministers...
and central bank governors who met on a regular basis to discuss co-operation on economic and financial policy.

The hope for the G-20 was that it would be better suited than other international financial institutions (IFIs) to promote international financial stability. However, the 2008 financial crisis, and the ensuing global recession, highlighted the elusiveness of this charge. On the one hand, the crisis exposed the limits of the G-20’s ability to prevent economic crisis; on the other hand, leaders quickly identified the G-20 as a focal institution where they could meet to co-ordinate swiftly and effectively the national responses to the crisis. In 2008, President George W. Bush called leaders from the G-20 member states to Washington to create a plan for restoring financial stability and preventing worsening of the crisis (the Washington Action Plan). In doing so, the G-20 was transformed into a leaders’ summit. The institutionalization of the Leaders’ G-20, held in addition to the Finance G-20, turned out to be a permanent and significant institutional adaptation to the financial crisis, as it shifted decision-making and policy co-ordination efforts to the highest levels of leadership and lent the forum increased authority. Moreover, this move turned an essentially technocratic body into a decidedly political one (Helleiner and Pagliari 2010; Moschella and Tsingou forthcoming).

At the 2009 Pittsburgh Summit, member states declared the G-20 to be the ‘premier forum’ for economic co-ordination, and so supplanted the increasingly marginal G-7/G-8. Today, most important institutions in the field look to the G-20 summits for guidance and support, turning it into a natural centre for discussing and co-ordinating financial regulation.

**Institutional design and governance functions of the G-20**

In order to understand the challenges and the potential of the G-20, it is useful to first identify the core features of its institutional design and governance functions. The G-20 is a forum designed to promote informal discussions among a set of states with large and interconnected economies. As such, two of its most important institutional characteristics are that it is intentionally informal and exclusive. According to its own self-understanding, the G-20’s broad mandate is to ‘shape the international agenda, to discuss economic and financial issues in areas where consensus had not yet been achieved, and to “lead by example”’ (G-20 History 2007, 5). Indeed, it is most often characterized as a ‘forum for dialogue’, or as a ‘network’, or a ‘steering committee’, underscoring its informal and unbinding nature (Cooper and Bradford 2010; Martinez-Diaz and Woods 2009; G20 History 2007, 51). Given the fact that the G-20 does not have the authority or institutional capacity to be a regulatory body, it would seem to be very limited in its ability to engage in governance functions. And yet the G-20 has come to be regarded as one of the most important governance institutions in global finance (Lagarde 2011). The G-20’s greatest influence on governance comes through its agenda-setting power and its ability to engage in policy co-ordination, both co-ordinating national policies and orchestrating IFIs to carry out its governance agenda. In the following discussion I assess the G-20’s informal structure, exclusive membership, agenda-setting power, and policy co-ordination efforts in order then, in part III, to evaluate critically how these contribute to, or hinder, the G-20’s legitimacy and effectiveness.

**Institutional design of the G-20**

**Informal structure**

Compared to most IGOs, the G-20 is an informal institution, meaning that it has no formalized rules or operating procedures and no permanent staff of its own. It has no charter, it does not
take votes and decisions are not legally binding. Nevertheless, this does not mean that the G-20 is completely lacking an institutional structure. The Group is directed by a chair that rotates annually among all regions and between countries of different levels of development. The incumbent chair establishes a temporary secretariat and website. In order to establish continuity and coherence in the G-20’s management, the current chair is joined by the past and future chairs in a three-member team called the troika. The G-20 works as a series of meetings that are held off the record and are oriented toward finding consensus. The G-20 meetings aggregate preferences, which get articulated as common objectives in Action Plans, Frameworks and Communiqués.

The relative informality of the G-20 can be a double-edged sword. Its informal structure means that decisions are non-binding and there are no formal control mechanisms, monitoring arrangements or coercive enforcement options. On the down side, this means that the G-20 has difficulty enforcing its decisions and policy agenda, even among its own members. The G-20 is also unable to be a strong delegator because, as principal, it has no power to invest potential agents (for example, the World Bank) with authority vis-à-vis targets and cannot sanction or rescind the agents’ authority (Abbott et al. 2011, 5). The most that the G-20 can do is to ‘call upon’ potential agents to support its agenda. A further consequence of informality is that the absence of reporting requirements to domestic governments or external monitors, combined with the absence of an independent and permanent secretariat, mean that the G-20 is hardly subject to any accountability mechanisms, which has a negative impact on its legitimacy and a potentially negative impact on its effectiveness.

On the other hand, informality allows the institution flexibility and room to manoeuvre that are not easily found in the Bretton Woods Institutions (BWI). The absence of strict procedural rules and the non-binding nature of decisions appear to mitigate the problems of bargaining and posturing apparent in other IOs. The G-20 attempts to promote frank discussion and to approximate the informal get-together quality that the original ‘Library Group’ initiated in 1973 (Hajnal 2007). According to the G-20 itself, ‘The keys to its success have been the ability of the Group to engage in meaningful debate, frankly and informally’ (G-20 History 2007, 6). Another observer noted that the expanded Group demonstrates ‘the value of fresh, practical, and less institutionally based dialogue and co-operation’ (De Brouwer 2007, 82).

This is in contrast to critiques of more formal financial institutions, such as the IMF. Work at the IMF is structured by layers of rules and procedures, in addition to a deeply embedded organizational culture, which make quick, flexible and innovative policies difficult to achieve. Moreover, the Fund is staffed by economists with little direct experience of the institutions and political realities in member states (Barnett and Finnemore 2004; Chwieroth 2009). The G-20, in contrast, is unencumbered by rules and a bureaucratic apparatus, and it can bypass the difficult work of hammering out minute implementation plans—something that most IGOs, largely implementing institutions, cannot do on their own. Furthermore, the presence of state leaders at the G-20 summits gives the G-20 unprecedented decision-making power.

Exclusive membership

The G-7 was careful to design the G-20 to be more inclusive and more representative of systemically important actors than previous groupings and even other IFIs. Thus, the G-20 expanded on the membership of the G-7 to include 19 states representing all regions of the world, the European Union (the 20th member) and the Bretton Woods institutions. There are four significant components to the G-20’s membership: (1) it includes both states and other IOs; (2) it is exclusive rather than universal; but (3) it includes systemically important states; and (4)
these states have an equal voice. The G-20 is only one of a few institutions that bring together advanced industrial economies, the increasingly significant emerging countries and IOs.

The G-20’s inclusion of emerging economies is one of its main claims to legitimacy. The G-20 likes to emphasize that it represents about 90% of global gross domestic product (GDP), 80% of global trade and two-thirds of the world population (G-20 website 2012). Perhaps more importantly, the states represented at the G-20 have equal standing. In contrast to the IMF or World Bank, at the G-20 emerging economies have an equal seat at the table and they have equal access to chairing the Group. As chair, a country has discretion to set the agenda for the Group according to its own interests. This has allowed China, for example, to focus the attention of the Group on reforming the Bretton Woods institutions, and India to focus the Group on development and aid (G20 History 2007, 41). More generally, whereas the IMF has traditionally viewed developing countries as problems that need to be fixed, the G-20 has incorporated many of them as part of the solution.

At the same time, however, the G-20 is an intentionally exclusive institution. After experimenting with larger groupings (such as the G-22 and G-33), the G-7 determined that exceeding 20 members would compromise the intimacy and effectiveness of the Group (G20 History 2007, 12–20). One of the perceived problems of the IMF is that its universal membership endogenizes a range of diverse interests. Interest divergence among actors often requires longer and harder bargaining to get agreement on policy, and that agreement might reflect a lowest common denominator policy rather than an effective one. The G-20, in contrast, attempts to be inclusive enough to command legitimacy, while being exclusive enough to ensure a certain level of interest convergence and, therefore, improved effectiveness.

Nevertheless, selective and untransparent membership criteria have led to criticisms that the G-20 is not representative and, therefore, not a legitimate governance institution. Seen this way, the G-20 excludes more than 80% of the world’s countries, even though many of these states, such as Spain and Poland, explicitly wish to be included. While the G-20 argues that its members must be ‘systemically important’, there are no explicit criteria for assessing this status. Some large economies with important banking and financial services sectors, such as Switzerland, are excluded. Most small countries are excluded, even though the crises in Iceland and Greece have shown that small economies can create significant externalities.

**Governance functions of the G-20**

**Agenda-setting**

The G-20 has been intentionally broad in defining the issues that it addresses, which range from loan-restructuring to terrorist-financing to environmental concerns, but financial stability has always been the cornerstone of its mandate. The period between the Asian Crisis and the 2008 Global Crisis, in particular, saw a broadening of the G-20 agenda. In this period, states holding the G-20 chairmanship used the opportunity to emphasize themes of particular importance to them (G-20 History 2007, 41). After the 11 September terrorist attacks, US allies holding the chair made combatting terrorist-financing a major theme of the meetings. During their tenures as chair, India, Mexico and China were instrumental in moving the G-20’s focus to development and aid issues. China has used its chairmanship to pursue BWI reform. And, just before the global economic crisis, Germany, China and Australia put demographic changes onto the agenda.

However, since 2008 the primary concern of the G-20 has refocused on the prevention and mitigation of the global economic crisis. Initially, the G-20 focused on co-ordinating immediate
measures such as national stimulus plans and avoiding protectionist measures. In attempting to address underlying causes of the crisis, the G-20 has since given high priority to international regulatory reform; that is, articulating policy goals for international prudential regulation, and monitoring and enforcement mechanisms for public and private financial actors. A central concern has been to strengthen the regulation and supervision of banks, hedge funds and derivatives. As a result, the first G-20 summit in Washington at the end of 2008 developed 47 immediate, medium- and long-term goals regarding transparency and accountability, coherence in regulatory regimes, financial market oversight, risk management and reform of Bretton Woods institutions (Washington Action Plan 2008). The 2009 Pittsburgh Summit introduced the Framework for Strong, Sustainable and Balanced Growth (FSSBG), the core of which is the Mutual Assessment Process (MAP), which assesses progress on Framework goals, particularly those meant to identify and rectify global imbalances. Subsequent summits have emphasized the creation of a single standards regime, the extension of regulatory principles to new areas, and the institutionalized monitoring of systemically important financial institutions. The G-20 has endorsed important existing regulatory regimes such as the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, and agreed upon the development of others, such as the Principles for Sound Liquidity Risk Management and Supervision, which introduces new liquidity rules, and the Principles for Sound Compensation Practices, which specifies principles for banker compensation that are designed to constrain excessive risk-taking.

Policy co-ordination

There are two main functions that the G-20 fulfils that make it a significant regulatory actor and more than a mere agenda-setter. First, the G-20 meetings facilitate the co-ordination of national policies, to ensure that domestic policies are working toward the same collective goals. This was particularly important in the immediate response to the 2008 global financial crisis. The G-20 agreed to collectively stimulate demand and it facilitated the concerted expansion of fiscal and monetary policies in member states. It also reached consensus among members on the need to avoid protectionist measures and competitive currency devaluations. These initial co-ordinated domestic measures are generally credited with having prevented a worsening of the crisis (Cooper 2010; Cooper and Helleiner 2010; Heinbecker 2011).

The first several summits also led to the conclusion that long-term efforts to prevent crises will require more, and more systematic, co-ordination of national policies. The MAP, in particular, was conceived as a new approach to policy collaboration. One of the central aims of the MAP is to correct global imbalances over the medium term. Towards this goal, the MAP called on all member states to submit national policy plans and expected economic performance data for assessment by the IMF. The IMF was charged with assessing the extent to which individual plans were consistent with G-20 objectives. G-20 members later agreed to an enhanced MAP that would establish guidelines to monitor policy progress toward collective goals, and that required G-20 members to identify domestic policy actions to further long-term collective growth objectives (IMF 2009).

The second way in which the G-20 co-ordinates is by ‘orchestrating’ other IFIs—such as the IMF, Financial Stability Board (FSB) and International Accounting Standards Board (IASB)—to carry out the governance tasks agreed upon among states at G-20 meetings and summits (Viola forthcoming). Indeed, orchestration is a mode of governance that distinguishes the G-20 from the work of other groupings, such as the G-7 or G-8. According to the orchestration model, a governance actor, such as the G-20, with a capacity deficit that impedes it from engaging in hard or direct regulation can ‘outsource’ the regulation of its governance targets by working
through other available public or private actors called ‘intermediaries’ (Abbott et al. 2011). Orchestration is distinct from delegation because the orchestrator, unlike the principal in delegation, does not invest intermediaries with authority vis-à-vis targets (they must already possess this authority independently of the orchestrator), and the orchestrator does not have the power or resources to sanction or rescind the intermediaries’ authority (Abbott et al. 2011, 5). Intermediaries, unlike agents, may accept or decline to carry out a request by the orchestrator, as this is a voluntary interaction.

Because of the nature of its institutional structure, the G-20 itself is not able to implement or enforce policy recommendations and it cannot obligate other institutions to carry out its tasks. Therefore, the G-20 ‘calls upon’ intermediaries, such as the IMF, FSB or IASB, to voluntarily implement governance goals agreed upon at the G-20 by engaging the regulatory targets. One way in which the G-20 accomplishes this is by co-ordinating the supply of resources to IFIs. At the second summit in London in 2009, for example, leaders agreed to substantially increase resources to the IMF in order to facilitate its lending activities, including providing bilateral financing of US $500,000m. (London Declaration 2009). This was followed by the Pittsburgh Summit commitment to a $350,000m. capital increase for the Multilateral Development Banks. But the more significant G-20 influence over IFIs comes from its self-ascribed authority to draft detailed policy recommendations. In November 2008, for example, the G-20 requested that the IMF and FSB take on the main role in crisis prevention surveillance and charged these with creating what has come to be the Early Warning Exercise. The G-20 has also requested that the FSB, along with other institutions such as the IASB, co-ordinate and unify the work of national, international and private standard-setting bodies and then report back to the G-20. These interactions fall short of delegation. The G-20’s request that the IMF support implementation of the MAP is exemplary in this regard, as the IMF explicitly states that ‘the Fund may choose to accept or decline’ the G-20’s request for assistance and that this request is not legally authorized under Article IV (IMF 2009, 6).

III Legitimacy and effectiveness of the G-20: challenges and responses

The legitimacy, effectiveness and future relevance of the G-20 for global economic governance will depend on how it overcomes the shortcomings—and exploits the benefits—of its institutional design and governance functions. Legitimacy and effectiveness are intertwined. Legitimacy refers to the extent to which an institution’s authority is voluntarily accepted and respected (Hurd 1999, 381). Legitimacy depends both on an institution’s procedural fairness and also on the quality of its output (Scharpf 1997). We can expect, then, that limited representation and procedural transparency will tend to reduce the legitimacy of the G-20; but this tendency has the potential to be offset by a very effective G-20. At the same time, effectiveness itself might be improved by fair and transparent procedures because these expose an institution to input from a greater number of relevant actors, and because legitimacy can enhance incentives to comply with decisions. However, as it currently stands, both the G-20’s effectiveness and its legitimacy are coming under fire, especially as the public loses patience with the lack of financial sector reform coming out of the summit process that appears to reinforce the market interests of select powerful actors (Barysch 2010; Vestergaard and Wade 2012). In this section I analyse the legitimacy and effectiveness challenges presented by the four specific institutional features and governance functions of the G-20 identified above—membership, agenda-setting, policy co-ordination and institutional structure—and assess the G-20’s actual and potential institutional response to these challenges.
Membership

The G-20’s larger membership as compared to other informal groupings is a reflection of broader shifts in economic power within the international system. The economic significance of the emerging economies made their inclusion necessary to any serious effort at global financial co-ordination. However, at the same time, this expansion has been limited, and the G-20 remains an exclusive institution. The G-20’s exclusivity presents a serious challenge to its legitimacy and effectiveness.

One significant problem with exclusivity is that G-20 decisions and recommendations, while being made by a small group of states, can have substantial implications for non-member states. There are no mechanisms, or even normative obligations, for the G-20 to consult with or report to non-member countries affected by its policies. In an effort to crack down on tax evasion, for example, the G-20 published a list of tax havens that have failed to meet transparency expectations. French President Nicolas Sarkozy went as far as saying that offenders ‘will be excluded from the international community’ and that ‘we don’t want to have tax havens anymore’ (Allen 2011). States relying on offshore banking activity but not represented at the G-20 were incensed, both because they fear the economic consequences of such a move and because they dispute the idea that a self-appointed group could ‘decide’ to exclude them from the international community.

Moreover, because the G-20 instructs international organizations (IOs), such as the IMF, to take specific actions, it is able informally to bypass the authorized decision-making processes of those organizations. Among non-member states, such as many Latin American countries, there is concern that the G-20 can use its influence within IFIs to dictate new rules to G-20 outsiders, especially with respect to the financial crisis and international development. The G-20’s ability to bypass universal membership organizations has been strongly criticized among non-G-20 UN General Assembly members, as the G-20 has avoided co-operating with the UN General Assembly and thus has successfully circumvented the concerns of these states (Heinbecker 2011, 11).

The G-20 has limited its membership in part out of efficiency considerations, namely the concern that inclusion of too many disparate countries would strain its ability to reach consensus, and it maintains that its limited size is part of its success. However, efficiency concerns also mask potential conflicts of interest. Another motivation likely at play for established economies is that the inclusion of additional emerging and other non-Western economies could result in a shift in the balance of institutional power. While the voting quota system at the IMF makes it difficult for balancing coalitions to be effective there, the less inclusive but more equal G-20 has already enabled emerging economies to co-ordinate with one another to bargain harder for their preferred reforms. This was the case, for example, in the negotiations on New Arrangements to Borrow (NAB), an arrangement by which a group of members provides the IMF with supplementary resources when these are needed. Within the G-20, China, Brazil, Russia and India successfully pushed for an arrangement by which the four of them could collectively veto activation of IMF credit lines (Woods 2010, 9). Continued exclusivity puts a limit on the bargaining power of non-Western states and prevents a potential shift in the balance of institutional power.

How has the G-20 attempted to respond to these concerns? While the lack of explicit and formalized membership rules has been frustrating for non-members, it has also afforded the G-20 discretionary flexibility in who can attend meetings and who belongs to the group. The G-20 has attempted to include non-members by issuing ad hoc meeting invitations to non-member states. Spain, for example, was unsuccessful in its attempts to become an official member of the G-20 but it is nevertheless included as a ‘permanent guest’ in all G-20 meetings. The inclusion
of non-members was more directly addressed at the G-20 Toronto summit, which made an explicit effort to be more inclusive. It was marked by much wider participation of non-G-20 countries, including Algeria, Colombia, Egypt, Ethiopia, Haiti, Jamaica, Malawi (representing the African Union), Netherlands, Nigeria, Senegal, Spain and Viet Nam (representing ASEAN). This move reflected the G-20’s acknowledgment of concerns that the G-20 would reach agreements without the input of and without reporting back to affected non-G-20 countries. Now all G-20 summits include some countries from outside its direct membership.

Despite these attempts at informal inclusion, the G-20 has not arrived at an institutional solution to deal with those excluded. Indeed, the ad hoc nature of non-member country inclusion emphasizes the asymmetrical relationship between insiders and outsiders and the institutional intransparency of the G-20. Especially as the G-20 takes on a governance relationship over the IMF, the tension between an elite ‘steering committee’ and the larger group of affected stakeholders can be expected to increase. This is already leading the excluded to form new, alternative institutions, or to find better means to co-operate. Indeed, a number of non-member states, under the leadership of Singapore, have created the Global Governance Group (3G) to co-ordinate and communicate their views to the G-20. To avoid undermining its own legitimacy, the G-20 would need to create formal mechanisms of outreach to non-members (both states and non-states) and systematize membership rules by, for example, including members who represent regional constituencies.

Agenda-setting

Despite the ‘like-mindedness’ created by the G-20’s exclusivity, existing G-20 members have different priorities when it comes to financial governance. These lines of difference are especially visible between developed and emerging economies. Emerging economies have been primarily interested in reform of governance institutions and the strengthening of development aid, both of which require concessions by developed countries. Developed countries, in turn, have been primarily interested in preventing protectionism, stabilizing currencies and preventing tax evasion, which tend to have implications for policy change within less developed and emerging market countries.

After the Asian Financial Crisis and before the current financial crisis, the G-20 responded to differences in priorities by expanding its agenda to include topics not directly related to financial governance. The emphasis shifted away from crisis prevention and resolution to the broader and longer-term challenges of globalization. The rotating chair of the G-20 allowed emerging economies to bring topics such as development and aid, IFI governance reform and increasing commodity prices onto the agenda (see G-20 History 2007, 41, Table 1). However, with the latest financial crisis attention has again refocused on financial issues more narrowly construed. Terrorism, food and energy security, and climate change have been largely neglected, while development aid has been addressed only in a secondary way. The main components of the response to the financial crisis have been attempting to co-ordinate national stimulus action, committing resources to the IMF and discussing financial market reform. The summit action plans focus on improving country surveillance and monitoring programmes as well as promoting reform of accounting and banking standards.

There is an argument to be made that the continued relevance of the G-20 depends on its ability to expand its agenda once again. Andrew Cooper and Eric Helleiner, for example, propose that the G-20 needs ambitiously to expand its mandate in order to maintain its relevance and momentum, even as the imminence of the financial crisis recedes. They argue that ‘[a]bundant risks exist for the G-20 if it does not ambitiously expand its mandate’ and so the G-20 should...
tackle key global public goods such as climate change, food security and global health, and encourage transfers of knowledge, wealth and technology (Cooper and Helleiner 2010, 10; see also Carin et al. 2010, 5; Heinbecker 2011, 4). The fear is that leaders will reduce their involvement in and commitment to the G-20 if it does not continue to be involved in a variety of issues. According to this view, ‘The G-20 must go on the offensive and show that it has the functional capacity to deal with pressing global issues’ (Cooper and Helleiner 2010, 3).

However, another argument contends that the G-20’s involvement in a wide array of issues creates confusing overlap and fragmented authority (Zedillo 2010). From this perspective, the move away from financial sector reform after the end of the Asian Financial Crisis and towards other topics may have weakened the G-20’s ability truly to engage in the kinds of reforms that could have mitigated the recent global crisis. While attention to a broader range of issues might keep the G-20 in the spotlight, global governance might be better served by having the G-20 specialize in specific governance issues. Unlike with global trade and the WTO, after all, there is no agency directly tasked with global financial regulation. The creation of such a centralized agency might be more effective and more legitimate for the purposes of global financial governance (Eatwell 2000).

The larger question at stake here is whether the G-20 is best seen as a ‘steering committee’ or a ‘crisis buster’. The latter requires a more reactive posture, a flexible G-20 ready to engage in policy issues as they become relevant. This approach emphasizes the ability of the G-20 to quickly convene leaders of the world’s most influential states when they are confronted by urgent threats—such as major terrorist attacks, skyrocketing energy prices and supply constraints, or exploding commodity prices. The G-20 would act as a quick-reaction team and would need to remain flexible to adjust quickly to events by adopting practicable action plans. The other governance view envisages the G-20 as a global steering committee that invests up front in a range of specific long-term challenges. In this model the G-20 would concentrate on a set of issues that it would supervise over time.

Policy co-ordination

In order to avoid an outcome worse than the Great Depression of the 1930s, it was clear in 2008–09 that states needed to avoid beggar-thy-neighbour protectionist measures and to commit to stimulus measures at home. The G-20 played a pivotal role in getting member states to co-ordinate policy on national fiscal and monetary expansion, as well as co-ordinating an exit from these measures. This level of policy co-ordination was enabled by an early institutional adaptation, namely the decision to upgrade the G-20 to a leaders’ summit. The G-20’s two-track existence, as a forum for ministers and as a leaders’ summit, has enhanced its ability to take strong action. A leaders’ summit reduces the principal-agent problem that is more intensely faced by ministers acting as agents for their leaders. Leaders are able to agree to trade-offs, make concessions and exert pressure in a way that finance ministers and central bank governors cannot.

During the height of the crisis, some form of global response was in the interest of nearly all states, so it was not too difficult to get states to agree to some basic policy co-ordination. But as the crisis recedes it has become increasingly difficult to reach common ground on issues such as resolving trade imbalances, increasing financial market regulation and IMF governance reform, making deeper co-ordination difficult. Initial expectations that the crisis would lead to joint action to overhaul financial governance have been disappointed. Moreover, as the G-20 agenda widens again, achieving policy coherence on a larger set of issues seems illusive given the diverse interests and priorities of states. Moving forward, the G-20 faces the problem of internal fracturing.
Embedded in these difficulties are both questions of legitimacy and effectiveness. The perceived legitimacy of the G-20 will be influenced by how well it is able to come to equitable policy arrangements given the mix of developed and emerging economies that comprise it. In the absence of formal mechanisms for aggregating preferences, the relative power and influence of members will be decisive in determining the fault lines along which policies can be determined. In the absence of a manifest crisis, there is a risk that the interests of smaller or emerging economies will be marginalized and that the G-20 turns into a forum used by a small group of developed countries to generate broader support for their own preferences. On the other hand, over the last decade the emerging economies have developed the skills and capacity to manœuvre within the G-20—including the capacity to build coalitions and caucuses (Martinez-Diaz and Woods 2009; Woods 2010). However, the development of caucuses within and ad hoc groupings outside the G-20, threatens to undermine the focal nature of the G-20 and its effectiveness in reaching coherent outcomes.

One possible response to these challenges would be to limit ‘one-size-fits-all’ solutions and instead to intensify work on tailor-made solutions to common problems, such as within the MAP, which take into account the needs of individual states. However, over the long term, it is likely that the G-20 will only be able effectively to co-ordinate policy by undertaking some institutional reforms. Thus far there have been no attempts to create such an institutional response. No new mechanisms for aggregating preferences and overcoming dissensus have been introduced, and divergent national interests make institutional strengthening—in the form of increased delegation, for example—difficult to achieve.

In addition to the co-ordination of national policy, the G-20’s ‘orchestration’ relationship to other international institutions is a source of legitimacy concerns. The G-20 currently ‘outsources’ the implementation of its agenda to other international institutions, even though the G-20 has no official authority over them. Thus far, the IFIs have been co-operating with the G-20. However, over time, disagreements and turf-battles are bound to appear. It is important for the G-20 to clarify its agenda and mandate compared to other institutions, even while maintaining the network nature of their interaction. The G-20’s relationship to the UN is already marked by tension directly related to its exclusion of states otherwise represented at the UN. Seeking out a consultative relationship with the UN General Assembly might allay fears that the G-20 appears to be superseding it as a decision-making body.

**Institutional structure**

The G-20’s weakly institutionalized structure and quasi-informal nature provide it with a useful kind of flexibility that has, in some ways, increased its effectiveness over other more formalized IFIs such as the IMF. The G-20 has, for instance, been credited with breaking the deadlock within the IMF over quota reform. By moving discussions of financial governance to an informal group with no explicit institutionalization of inequality, the Group appeared to satisfy calls for an open and fair governance reform discussion that was too contentious to pursue within the IMF. But the Group’s lack of authority to directly implement any changes made this a relatively cheap move, while at the same time possibly forestalling a move by non-G-7 countries to pursue more radical reform strategies. In this way, the G-20’s combination of institutional weakness with agenda-setting power can be instrumentally used to avoid deep reforms on issues that are controversial for powerful interests (Stone 2011).

A further limitation of the G-20 is that its informality means that it is unable to enforce member state compliance with its agreements, with obvious implications for effectiveness (Zedillo 2010). Meanwhile, the freedom won from the absence of formal rules and procedural
transparency also means that the G-20 is able to set the regulatory agenda and decide on which IOs to support without being constrained by internal or external accountability mechanisms. The inaccessibility of the G-20 for outside actors, especially civil society actors, also compromises its claims to legitimacy. G-20 summits have been accompanied by protests from civil society actors who see the Group as complicit in creating the inequality and poverty associated with globalization.

The G-20 has made some structural changes in response to the efficacy challenges that it faces. The greatest amount of movement in this direction has happened not at the G-20 itself, but in the G-20's support for greater formalization of the FSB. In addition to rebalancing its membership, in 2012 the FSB agreed to formulate Rules of Procedure to improve its internal governance, to create Standing Committees and to investigate the possibility of vesting the FSB with legal personality under Swiss law (for more on the FSB see Pagliari this volume). The G-20 itself has done less to explicitly address its governance capacity. In an indirect way, the MAP can work as a monitoring mechanism. The MAP develops and implements common yardsticks to assess member progress on commitments made within the G-20. But the MAP is essentially an internal mechanism without any teeth. Strengthening the MAP into a harder accountability mechanism that also makes binding policy prescriptions would be one step toward giving the G-20 a stronger institutional structure (Subacchi and Jenkins 2011).

The most common proposal for G-20 reform is the call to create a permanent secretariat (but see the recommendation for a 'non-secretariat' in Carin et al. 2010). A permanent secretariat could improve continuity and follow-through from summit to summit and it could take more control over setting the agenda, making it more systematic than ad hoc. In its most structured form, the G-20 could become a type of Global Economic Council with clear procedural rules and a well specified mandate. But such changes would require more bureaucratization and it would most likely come at the expense of member state flexibility. At this point, the G-20 appears unlikely to undertake any major changes that would significantly increase its formalization or bureaucratization.

Perhaps a more likely, and more important, step would be for the G-20 to create institutional mechanisms for more formal and systematic consultation with non-member states and non-member organizations. Such mechanisms would help to offset concerns that the G-20 is not transparent, and they might improve both the legitimacy and effectiveness of the Group by allowing more input from outside without compromising the internal coherence of the group. The G-20 does engage in informal consultation with other actors, but the ad hoc and asymmetric nature of this engagement does not do much to improve its legitimacy. The legitimacy of the G-20 could be greatly improved by opening official avenues of access for unrepresented groups, as most other IGOs have already done.

**Conclusion: the G-20 after the global financial crisis—failure to adapt or big new player on the block?**

Emerging from this assessment of the G-20 are two competing narratives. On the one hand, the G-20 appears to be a big new player in global financial governance, taking on a leadership role in the aftermath of the crisis. Moreover, the G-20 represents two significant institutional innovations. First, its membership reflects a growing realization that the balance of power among the central players in the global economy has shifted and that existing institutions insufficiently reflect this shift. Second, its own institutional flexibility and its networked interaction with the IFIs that it orchestrates reflect a leaner, more agile, rapid-reaction force than the cumbersome, phlegmatic and entrenched IGOs of the post-World War II period. The proliferation of ad hoc
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clubs of common interest represents a contemporary experiment in governance that will likely shape institutional forms in the future.

On the other hand, the G-20 has also largely failed to adapt to challenges to its efficacy and legitimacy. Institutional changes are, and will remain, difficult to implement in large part because of the divergence of interests among the member states. States have proven unwilling to give up sovereignty by delegating power or empowering the G-20 with enforcement mechanisms, and they have proven reluctant to make deep regulatory reforms even after having experienced life on the brink of economic collapse. Even more problematic is the possibility that the deliberate weakness of the G-20, combined with its aspirations of authority, may be an intentional roadblock towards deeper financial governance reforms.

One of the most serious critiques against the G-20 is that it has used its unique combination of authority and weakness to promote a policy agenda in the interest of its strongest members while deflecting, or even impeding, calls for stronger financial governance where this is not in the interest of key players. The G-20’s weak institutional structure allows states to deflect pressure away from calls for stronger financial governance and more equitable distribution of governance authority, while its leadership on global financial issues may hinder other forms of financial governance from emerging.

Thus, while this chapter has pointed to a number of institutional solutions that could mitigate both the G-20’s efficacy and legitimacy challenges, whether they will be adopted depends on the ability of member states to overcome their short-term interests and to find the common political will to invest in an institution capable of deep reforms that may be unpopular in strong financial and economic capitals.

References


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The role of private governance in global finance

Heather McKeen-Edwards and Tony Porter

Introduction

Private sector governance plays a key but complex and varied role in global finance, as in global economic governance more generally. It encompasses a range of activities that include best practices, codes of conduct, model contracts, professional designations, formal standard setting bodies, adjudication mechanisms, risk management technologies, computer codes in electronic systems, strategic road-mapping projects and many other such mechanisms, which influence both macro- and micro-level financial activities. Private forms of governance interact with public regulation in complex ways—competing with it in some cases and reinforcing it in others. Some forms, like the New York Stock Exchange or Lloyd’s of London, have centuries-long histories displaying impressive resilience and adaptation; while others, such as the new procedures for determining payments of credit default swaps, have only been created since the 2007–08 crisis. Some mechanisms, like the International Accounting Standards Board’s accounting standards, are global in their intended scope, while others focus specifically on a single region or financial activity.

Drawing on our analysis of information that we gathered on 225 transnational financial associations in our recently completed book manuscript on the role of transnational associations in global finance (McKeen-Edwards and Porter 2013), this chapter will provide a survey of private governance mechanisms in global finance. We argue that, although powerful players and paradigms are important in private governance, it is also crucial to consider the governance roles played by business practices and infrastructures. Overall, a number of distinct but interrelated private sector roles in global financial governance can be identified. One role is to influence and work with public authorities at the national and transnational levels. This can go beyond lobbying to include more complex collaboration with public authorities in the making or management of rules with public and private elements. A second role is the creation of sets of standards for the industry that are primarily private. Third, the private sector can serve to build the capacity and modify the conduct of firms through educational programmes, conferences and other forms of community-building, a process which often involves establishing codes of conduct or best practices. A fourth role is the creation or enrolment of objects that are crucial to market interactions, such as model contracts or the coding of electronic systems.
Finally, a fifth role is to integrate non-commercial values with the global financial system, as with Islamic finance and socially responsible investment.

As discussed below, the concept of an assemblage is valuable in analysing these mechanisms. This concept recognizes the way that relatively autonomous zones of governance can interact to produce broader patterns of private sector contributions to governance. Associations that possess relatively few resources of their own can greatly extend their influence by enrolling other relatively autonomous sets of humans and objects in their projects. Linkages among private sector roles in global financial governance are therefore crucial in understanding the significance of private governance overall. In the concluding section we consider the implications of this analysis for the legitimacy and effectiveness of private governance in global finance.

Conceptualizing private governance

For the purposes of this chapter we define ‘private’ as actors or rules that are primarily identified with business. As has been apparent throughout this book, ‘governance’ refers to a set of formal or informal rules that organizes a collectivity. There are very few, if any, instances of private governance that are entirely independent of all state influences. For instance, associations may rely on the state’s legal system for enforcing private contracts, or they may create private rules to forestall public regulation. Thus, in analysing private governance we are analysing rules that are significantly, but not necessarily, exclusively private in character.

There is a long history of private actors contributing to transnational governance in finance, including the organization of payments through lex mercatoria (merchant law) (Cutler 2003) in the Middle Ages, the intermingling of capital flows and government-like functions associated with the East India Company, or the close connection between British foreign and imperial policy and banking interests in the 19th century (Feis 1965). Many of these earlier forms of private transnational governance were eclipsed as states built their sovereignty, a process that reached its zenith in the mid-20th century. At that point private actors were relegated conceptually to domestic politics and law, and were generally seen as playing no significant role at the international level.

Private transnational governance received renewed attention as the mid-20th-century dominance of states in the practice and study of international relations began to wane. While the significance of private actors for global governance began to be recognized again in the 1960s and 1970s with the emergence of the field of international political economy, and the study in various academic disciplines of the multinational corporation and the policy problems associated with international markets, a more specific focus on private authority, rules, governance or regulation that was comparable in some respects to the governance provided by states began in the 1990s (Strange 1992, 1996; Cutler et al. 1999) and has since evolved into a large literature addressing a wide variety of transnational forms and functions of private actors and rules (for instance Büthe 2010; Büthe and Mattli 2011; Calliess and Zumbansen 2010; Cashore 2002; Flohr et al. 2010; Fuchs 2007; Graz and Nölke 2008; Hall and Biersteker 2002; Hansen and Salskov-Iversen 2008; Ougaard and Leander 2010; Porter and Ronit 2010; Ronit and Schneider 2009).

A number of scholars have focused specifically on the role of private actors in the governance of global finance. Tsingou (2006, 2007, 2008, 2010b), in particular, has analysed the following institutions: the Institute of International Finance (IIF), the most prominent international financial association, which has been the main interlocutor of the bank regulators that work through the Basel Committee on Banking Supervision (BCBS); the Group of Thirty (G30), a private think tank that has played especially important parts in governance in securities and

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derivatives markets; and the Wolfsberg Group, a group of leading transnational banks that focuses on anti-money-laundering and terrorist finance regulations. Tsingou has emphasized the durability of a transnational public/private policy community in which these groups and other private actors are well accepted participants, reinforced by the technical character of their work, the power of ideas and revolving doors between government and industry (Tsingou 2010a). Mügge (2008) has argued that private management of global financial governance is more likely when there is a stable set of dominant firms, while public authorities are likely to take the lead when this authority is absent. Sinclair (2005) has analysed the governance provided by credit rating agencies. Helleiner (2009) has examined the way that the IIF successfully headed off a formalized Sovereign Debt Restructuring Mechanism by promoting a less formal voluntary initiative instead. The International Swaps and Derivatives Association and its Master Agreement, which provides a template for most over-the-counter derivatives, has been analysed by Biggins and Scott (2011), Helleiner and Pagliari (2009) and Riles (2008). The International Accounting Standards Board (IASB) has also received particular attention (Mattli and Büthe 2005; Porter 2005; Botzem 2008; Nölke 2010). Since the crisis, significant attention has also been devoted to the issue of regulatory capture in global financial governance; Pagliari (2012) provides a comprehensive assessment of this problem and possible solutions.

In our research we have aimed to add to this literature by analysing the powerful but often unpredictable aggregate effects of very disparate private governance activities in global finance that might otherwise not be recognized as connected to one another. Often private financial power is conceived as emanating from a relatively relentless and unified source, such as the structure of global markets, the social dominance of financial elites or the power of neo-liberal ideology. In contrast, we argue that private power in finance, as elsewhere, must be painstakingly produced through practical activities of the type organized by associations, the internal procedures of firms or the coding of computer systems (Lessig 2006). The resulting practices, objects and norms are then brought together through processes of enrolment, where particular actors or networks manage to align the activities of a set of other relatively autonomous actors or networks in such a way as to produce power.

This approach means that private power is both more and less coherently integrated than is sometimes assumed. It is more integrated because the type of lobbying and regulatory capture that best fits with more conventional conceptions of private power is linked in unexpected ways with micro-level routines, such as the filling out of forms that are part of derivatives contracts based on the International Swaps and Derivatives Association’s (ISDA) Master Agreement (Riles 2008). Yet it is less integrated because power must be carefully and continually constructed in ways that are often prone to failure, and because it is built on the bringing together of quite autonomous zones of governance or organization that can then come apart or be reconfigured much more rapidly than would be the case if power relentlessly emanated from a single source.

In our research we have found the concept of an assemblage particularly useful in analysing the role of private power in transnational financial governance. This concept has a longer history in art and archaeology, where it refers to the bringing together of relatively autonomous elements to create a larger whole. Those elements might be linked to quite different uses, but their interactions with each other create an arrangement with its own distinctive meaning or purpose (DeLanda 2006). Assemblages can have agency, but this agency is not centralized in any one individual or organization. Instead it involves what Bennett (2010, 32–37) has called an ‘agentic swarm’: a form of emergent causality that evolves out of the interactions of relatively autonomous and sometimes conflicting sets of humans and objects. In the case of global finance, the concept of assemblage is helpful in analysing the way that ideas, humans and material objects, such as documents or computer systems, can create zones of governance that are
primarily oriented towards a set of particular purposes or functions, but at the same time work together with other zones of governance to produce larger governance assemblages.

What are the implications of this approach for the three Ps—players, power and paradigms—identified in the introductory chapter of this book? First, it suggests the importance of not focusing only on powerful players that explicitly aim to shape the governance of global finance as a whole, but of considering the role of smaller actors as well. It also suggests that such players are not just humans, but can include non-human objects. For instance, an automated trading system governed by a code can have similar effects to a group of humans following agreed standards. In general, humans and non-humans are entangled, co-producing the type of agency that players exhibit. Second, it suggests that power is not a resource possessed by individual players, but rather an effect that is produced by the painstaking enrolment and assemblage of sets of humans and objects. Third, it suggests that paradigms are not big free-floating ideas that capture the minds of humans, but rather sets of ideas and objects that fit together in distinctive ways for particular purposes that are not easily reconfigured. For instance, the idea of trading risk in derivatives markets is inextricably entangled with the ideas that inspired the ISDA’s Master Agreement, the expectations associated with any particular derivatives contract and the materiality of the paper that the contract is written on. This set of interdependent ideas and materiality constitute a paradigm-like structure, a relatively integrated assemblage, such that actors wishing to trade derivatives must comply with its rules and practices to a significant degree.

In the next section we develop these ideas by examining the five interacting roles of private actors that were noted above, focusing on associations. By ‘association’ we are referring to any form of organized private sector activity that extends beyond a single firm, not only traditional trade associations. These can include market practices and infrastructures. These latter activities tend to focus on micro-scale technical or commercial tasks. Their governance roles are less explicit, so they are often overlooked in analysis of global economic governance. Overall, we shall see that associations of varying scales are not nested parts of a single system, but rather relatively autonomous clusters of activity, all of which involve shifting, contingent and changing relationships across scales, as suggested by our assemblage approach. Given the number and complexity of the forms of private governance in global finance and the space constraints of this chapter we can only present illustrative examples of rules and activities that are more extensively discussed elsewhere (McKeen-Edwards and Porter 2013).

**Private sector roles in global financial governance**

There are relatively few associations that claim to represent or govern global finance as a whole and those that do are surprisingly weak, considering the size of private transnational financial activities. This challenges views that see private finance as associated with a single powerful force, whether this is conceptualized as a social class or a market structure. However, the linkages between the various private sector roles in governing global finance make those roles very significant. We discuss each of the five main private sector roles in turn. In doing so, the linkages between these roles will begin to become apparent. We then focus more directly on the significance of these linkages.

**Working with public authorities**

A first role is to influence and work with public authorities. The association with the most credible claim to represent private transnational financial actors as whole is the IIF, which claims on its website that it is ‘the global association of financial institutions’. However, it accounts for
only a relatively small part of the many transnational associational activities that contribute to the governance of global finance. Its primary role is to work with public authorities rather than to set its own private rules. However, its work goes beyond lobbying to include close collaboration with public authorities in rule-making. For instance, the IIF promoted greater reliance on the internal risk models of their member banks in the transnational bank regulation standards developed by the BCBS and, once integrated into the regulators’ standards and the banks’ internal operating procedures, a hybrid public-private mechanism emerged. The next most likely candidate for an association that represents global finance as a whole is the Global Financial Market Association (GFMA), which seeks to speak for the global securities industry. However, it is a relatively recent association, created in 2009, and it is not as active as the three regional member associations that constitute it: the Association for Financial Markets in Europe (AFME), the Asia Securities Industry & Financial Markets Association (ASIFMA), and, in the USA, the Securities Industry and Financial Markets Association (SIFMA). The GFMA operates more as an alliance of these regional associations than an independent centre of power and it does not produce rules itself. However, it is utilized by these members to influence public authorities like the International Organization of Securities Commissions (IOSCO) in their rule-making efforts.

Creating private rules

A second private sector role is the creation of private rules such as standards that are used widely in markets. There are two transnational associations that are particularly important in making and managing rules, although both only address one particular aspect of governance. The first of these is the International Accounting Standards Board (IASB), which sets financial reporting standards for most financial markets outside the USA, and which is co-ordinating closely with the US Financial Accounting Standards Board (FASB) to create a single set of global standards. Accounting standards are central to all aspects of global finance, since they measure, and to an important degree produce, financial values that otherwise would be too amorphous to have any meaning or effect. However, accounting as a whole is only one aspect of a much larger set of governance mechanisms and the IASB has made great efforts to insulate its standard-setting processes from other influences, not aspiring to influence the governance of finance in other ways. The second transnational financial association with an impressive private rule-making capacity is the International Swaps and Derivatives Association (ISDA). Unlike the IASB, the ISDA combines advocacy and the development of its own private rules. Its rules also interact with public rules in complex ways. For instance, ISDA has successfully lobbied to have legislators tailor national laws to enhance the effectiveness of its Master Agreement, a set of private rules embodied in private derivatives contracts, by putting them ahead of other contracts in bankruptcy proceedings (Biggins and Scott 2011). ISDA’s work is crucial for global derivatives markets, which are massively important, involving trillions of dollars of value. Nevertheless, derivatives, which are financial instruments that obtain their value by referencing a different financial instrument, are only one subcategory of financial instruments as a whole.

Mixtures of public influence and private rules at all scales

There are a great many less prominent associations than the ones discussed so far that similarly work with public authorities or create their own private rules, often combining both roles. Examples include the G-30, which consists of 30 prominent individuals from the public, private and academic sectors, and the Counterparty Risk Management Policy Group (CRMPG),
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which includes senior executives from about 10 of the world’s top banks. The Group of Thirty played a particularly influential role in successfully urging policymakers not to regulate derivatives markets in the mid-1990s and has issued many other policy recommendations before and after the financial crisis. The CRMPG similarly played an important role in convincing policymakers to back off on the regulation of hedge funds following the East Asian financial crisis of 1997–98, although it not only lobbied public authorities but also provided a set of voluntary standards and best practices, in part to reassure those authorities. It also produced two other reports on problems in global financial markets in 2005 and 2008. Other such associations include the Paris-based World Federation of Exchanges, with 54 member financial exchanges from around the world; the International Capital Market Association, which primarily lobbies and identifies best practices for international bond issuance and trading in Europe; the London-based Alternative Investment Management Association, which seeks to represent the global hedge fund industry and supports the Hedge Fund Standards Board; and the International Investment Funds Association, which represents the mutual fund industry. While each of these is important, none claims to govern or represent private transnational financial actors as a whole, but rather subcategories of actors.

Even smaller-scale associations, while less prominent, take on similar roles to the ones discussed so far. Some of these operate in a smaller subcategory of financial activities. Examples include the Global Association of Risk Professionals, the International Actuarial Association or the International Association of Financial Executives. Many others operate in a particular region, such as the European Covered Bond Dealers Association, the Latin American Banking Federation or the Federation of Afro-Asian Insurers and Reinsurers. Most of these are also similar to the larger associations discussed above in their varying combinations of advocacy and standard-setting activities and in their contributions to governance, albeit on a smaller scale.

Best practices and community building

A third private sector role in global financial governance is building the capacity and modifying the conduct of firms through educational programmes, conferences and other forms of community-building. This can often involve the creation of codes of conduct or best practices, forms of private rule-making that have been discussed above, although these rules often operate at a smaller scale and in a more informal manner than the rules created by the IASB or the ISDA. Understandings of appropriate practice that are reciprocally shared within a community permit the development of ordered exchanges over time (Greenwood et al. 2002). Once accepted, they can become increasingly seen as apolitical or natural, particularly if they are reproduced continuously through processes of training, certification and routinized interaction. In this way, as MacKenzie et al. (2007) remind us, emerging ‘best practices’ take on a performative role—creating zones of organized activity that contribute directly or indirectly to governance.

Examples of best practices include the IIF’s Guiding Principles, the Alternative Investment Management Association’s Sound Practice Guidelines and the various codes of ethics adopted by global and regional associations like the International Federation of Accountants and the Caribbean Actuarial Association, among others. More issue-specific standards and codes, while often voluntary in nature, can also serve as a potential source of best practice, as with the work of the Wolfsberg Group on specific standards for banks to address issues of money-laundering and terrorist-financing. However, it should be noted that there is significant variation in the effectiveness of such standards. Micro-practices are also often reinforced by the use of training programmes and certificates. The Institute for International Finance, the Arab Society for Certified Accountants, the Latin American Confederation for Savings and Loans Cooperatives and
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Women’s World Banking are just a few of the associations that provide such training. A number of associations, particularly those connected to professional fields, also offer credential granting programmes, including the Chartered Financial Analyst (CFA), Certified International Investment Analysts (CIIA) and the Financial Risk Manager (FRM). These designations are useful in improving the reputation and level of trust from other members of the financial community in their respective areas. However, they also explicitly develop and promote ‘best practice’ and techniques that can slowly harmonize practices in the industry over time.

Private associations can also work to build the capacities of communities of financial actors that have not traditionally been central to global financial governance. This includes the many associations that aim to enhance the capacity of Southern financial actors. Examples include independent efforts like the Accountancy Bodies of West Africa, which developed Accounting Technicians Scheme West Africa (ABWA n.d.), or the mutual enrolment of Southern associations and international bodies, like the ‘Train the Trainers’ workshops on international financial reporting standards (IFRS) for SMEs that were developed in co-ordination with different regional associations in the global South (IFRS n.d.). It also includes actors that wish to integrate non-commercial values with the financial system, which are discussed further below.

The widespread use of online programmes, products and tools has been an important way for associations to expand their reach, removing the geographic restrictions of traditional meeting spaces. These technologies also serve co-ordinative functions by distributing information and allowing members to interact with one another and the association in virtual space through discussion boards, virtual meetings and webinars.

The development and promotion of specific model contracts and master agreement templates act as discursive governance mechanisms rather than simple tools used by financial actors. The ISDA Master Agreement, discussed earlier, highlights the governance power that these kinds of standards can have. Many other associations have also developed model agreements to fill different specific market needs. For example, ACI, the Financial Markets Association, has a Model Code that addresses a range of issues that occur in financial markets, including gifts, the use of mobile devices for transacting, and the meaning of words, such as ‘done’ (ACI 2009), while the Financial Information Services Division (FISD) of the Software and Information Industry Association has produced an Exchange Contract Guide to facilitate contract negotiations among exchanges and other firms by identifying issues and providing sample contract language (FISD n.d.). Within the process of creating or completing these agreements, identities, relationships and obligations are explicitly laid out and practices are standardized.

Working with objects

A very important but often underestimated fourth role of the private sector in the governance of global finance is its configuration of objects that organize financial transactions or relations between financial actors. These objects have a materiality and autonomy from human actors that can strengthen and extend regularized interactions among human actors. As noted above, the materiality of the paper on which derivatives contracts involving the ISDA Master Agreement are written reinforces those rules, particularly when the contracts circulate far beyond the reach of any one actor. The use of electronic media for community-building and training has also been noted above. The IASB standards are woven into the fabric of markets through the professional practices of accountants, the published financial reports of firms and the ongoing calculations that are based on them in countless ongoing transactions, often carried out through machine systems.

The role of objects is especially visible in clearing and settlement systems (Quaglia 2011). When a commitment is made to pay for a purchase or trade there is a distinct set of behind-the-scenes
steps that must occur for the commitment to be implemented. The governance roles inherent in these practices are less explicit, and usually overlooked in analysis of global economic governance. Yet, the functioning of the system as a whole is threatened if the governance of behind-the-scenes procedures and technologies malfunctions.

In many countries associations play an important role in clearance and settlement, working with the central bank and for-profit corporations. For example, in the USA the implementation of securities market clearing and settlement has relied heavily on the Depository Trust and Clearing Corporation (DTCC), a transnational association managed by NYSE Euronext, the industry-run Financial Industry Regulatory Authority and other financial institutions that use its services, settling US $1,480,000,000m. in securities world-wide in 2009 (DTCC 2011). Internationally, the Securities Market Practice Group (SMPG) was created in 1998 to integrate the processing of securities trades drawing on International Organization for Standardization (ISO) standards and now includes 30 countries. International standards and operational guidelines for international credit transfers have been advanced through the International Payments Framework Association, which was created in 2010. In the EU, the Single Euro Payments Area (SEPA) project, initiated in 2008, is connected to regulatory and policy initiatives of public authorities, but it is also inextricably reliant on technical frameworks developed by the European Payments Council, an association of the major European banks and associations, and the national automated clearing houses will be required to integrate with the Pan-European Automated Clearing House (PE-ACH) (Janczuk 2010).

These clearance and settlement systems involve objects that are strongly constrained by certain technical requirements, including measures to reduce errors in the routing of payments. In the case of SEPA some of these requirements have been met by enrolling the IBAN bank-account identification number and the SWIFT-BIC bank identifier, two numerical codes that were developed by other associations. The Society for Worldwide Interbank Financial Telecommunication (SWIFT), a world-wide co-operative currently owned by its member-shareholders, is also a significant source of market infrastructure more generally. A key system for electronic communication in the industry, it handled roughly 18 million standardized financial messages related to payments daily by August 2012 (SWIFT 2012). Yet, to access these communications, financial bodies need to adopt a set of technical procedures to use the automated system effectively (McKeen-Edwards and Porter 2013).

Another important example of the role of private objects in governance is market indices. Indices play a key role in many markets, providing important information to financial organizations and investors when they are making risk and pricing decisions. For example, in 2011 the Wholesale Markets Brokers Association (WMBA), an association of money brokers involved in wholesale trading of derivatives and other instruments, launched a Repurchase Overnight Index Average Rate (RONIA). Market participants have viewed this as an important new index following the crisis because it provides a benchmark for hedging against risks for the increasing number of overnight borrowing transactions involving collateral (Shaikh 2011; WMBA 2011). Market indexes also remind us of the constructed nature of finance and the interplay between material and ideational elements in these processes because of the effects of different practices of construction on the resulting market object. This is apparent when we look at the differences between the Euribor and the euro BBALibor reference rates that measure the same thing. In each case, these rates are accepted as important market indicators and factored into decision-making practices by market actors. However, there are significant differences in the construction and measurement of the two indices, from the size of the panel of participants to subtler distinctions in the calculation and definition of each index. When these indices began to diverge during the crisis it was attributed to their distinct constructions.
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Furthermore, the recent scandal around the Libor has highlighted not only its governance role but also the potential of these infrastructures to contribute to financial instability and crisis. Libor, which effectively serves as a key figure on the cost of borrowing for banks, is used in a vast number of financial transactions with a total worth of at least US $300,000,000m. Once relatively obscure in governance discussions, the fraud that manipulated the overnight lending rate by a number of major banks (US Department of Justice 2012) and the related failure of this practice to address the inherent conflicts of interest in the rate’s calculation process has led the Financial Services Authority to begin a comprehensive reform process, including creating specific government regulation for Libor and taking over the oversight role from the British Bankers’ Association (Wheatley 2012).

Integrating non-commercial values with global finance

A fifth private sector role is to bring non-commercial values into the organization of global finance. To some degree, building the capacities of Southern actors is motivated by redressing power asymmetries and not simply promoting commercial opportunities. Other examples include social investment, Islamic finance and microfinance. In the case of the former, efforts to encourage the inclusion of social considerations in investment decisions have been largely pursued through the development and implementation of voluntary standards and reporting schemes in private bodies like the Global Reporting Initiative (GRI) and AccountAbility. In the Islamic financial services sector, associations have also taken on important standard-setting roles. For example, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), with over 200 government and private sector members from 46 states, has developed 80 different standards to meet specific industry needs. Finally, in microfinance, global associations like Women’s World Banking and regional organizations like Africa Microfinance Network have emerged to become important developers of best practice and providers of technical assistance and training. Governance in each of these areas engages with the mainstream financial system while also maintaining claims to distinctiveness, which create interesting tensions and controversies—as the recent public debates around microfinance illustrate.3

The importance of linkages and assemblages

The interconnections and overlaps among the five private sector roles in global financial governance have already begun to be apparent above, for instance in the way that private accounting rules can be reinforced by objects. The roles of private associations discussed so far match our comment above that private power is both more and less coherently integrated than is sometimes assumed. There is no overall integrated private association that represents or governs global finance, at first glance suggesting that private governance is very weak. However, the often-unrecognized linkages of the larger associations to other actors, objects or institutions tell a different story. These linkages amplify the power of the various private actors involved, in a manner consistent with the assemblage approach we have set out above. When linkages are strong enough to form a technical system, then it can operate like a paradigm with integrated material and ideational dimensions. However, these linkages must be constructed and they can fail. In addition, the associations may work towards quite divergent ends, or conflict with one another, although even in these cases their linkages may jointly contribute to a larger assemblage, as with the microfinance’s connections to large transnational banks.

When associations enrol other humans and objects to advance their goals, these linkages can be to other associations, as with the dependence of the GFMA on its three regional SIFMA
members or the WFE on its member exchanges. More informal linkages between associations were also evident in the joint letter sent to the public sector BCBS by various associations, including the ISDA, IIF and GFMA, on bank exposures to central counterparties—an issue that cuts across these associations’ areas of interest (GFMA 2011). However, there is a surprising degree of specialization at any particular scale among associations (rather than overlap or competition), and their most important linkages tend to lie elsewhere (Porter 2012), such as with public authorities or market practices and infrastructures. Moreover, when material objects such as documents or machine systems are enrolled they can greatly strengthen and extend the private practices that they facilitate.

However, private sector linkages do not only involve technical co-operation. Associations may compete aggressively with each other to dominate particular markets. One only needs to look at the overlap that occurs in professional designations and the efforts of different associations to control their market. This can also overlap with broader political conflicts. The expansion of USA-based DTCC into Europe has provoked reactions not just from European clearinghouses but from EU policymakers as well. In a different incident, the use of a SWIFT server located in the USA to track terrorist-financing led to a political backlash from the EU and the subsequent USA–EU agreement that removed the server, severely restricted US access to the data and secured commitments related to data privacy (Crook 2010).

Conclusion: the legitimacy and effectiveness of private financial governance and the three Ps

The global financial crisis that began in 2007 did serious damage to the legitimacy of private governance and revealed the limits to its effectiveness. The previous wide consensus among policymakers and regulators that markets could generally regulate themselves was replaced by a recognition that public authorities needed to play a stronger role. The previous consensus had seen private governance as involving not only private associations, but perhaps even more importantly the decisions of individual firms and investors to manage their own risks, either by choosing not to engage in particular activities, or by creating voluntary contracts, as with derivatives which can shift risk from one individual actor to another. In the midst of the crisis, while working on new standards, the IIF noted that

the development of industry standards does not represent an attempt at self-regulation; such efforts can identify and accelerate the spread of best practices, but cannot be—and are not meant to be—a substitute for supervisory oversight of regulated financial institutions. Such standards must therefore work in the context of an effective and efficient regulatory framework, adjusted as deemed necessary by the official sector, to rebuild market confidence.

(IIF 2008, 9)

A number of transnational reforms aimed to provide new mechanisms for public oversight of private actors and to thereby increase their accountability, legitimacy and effectiveness. For instance, a new international Monitoring Board of public authorities was established to increase the public accountability of the IASB. The International Organization of Securities Commissions updated its code on credit rating agencies (CRAs) to emphasize the need to separate ratings and fee generation, and the Group of Twenty Finance Ministers and Central Bank Governors (G-20) agreed to implement stronger regulation at the national level and to move
towards removing references to credit ratings in public regulations, although uptake on this was slow (Financial Stability Board 2011). New measures were taken to bring risks that were previously left to individual firms and investors to manage into public regulation. This especially included the Basel III revisions in international bank capital standards, which imposed capital requirements on banks’ trading books, and thereby began to better control the ‘shadow banking’ system which had been reliant on that trading. More generally, by calling for increases in bank capital to mitigate risks, Basel III sought to require private actors to bear the costs of the risks they take, rather than relying on their own self-interest to motivate them to do so. In some cases public authorities called for new private governance arrangements to be created, as with G-20’s call for derivatives-trading to be shifted to central counterparties (Helleiner 2011).

Despite the upgrading of public oversight of private financial actors in the wake of the crisis, reliance on private governance is far from being abandoned. In the larger private associations discussed above steps were taken to increase the legitimacy and effectiveness of their private governance roles, as with ISDA’s post-crisis reorganization of its governance structure (ISDA n.d.), revisions at the IASB in the ‘mark-to-market’ accounting rules that had contributed to the crisis, and detailed proposals for changes in private practices issued by the IIF (2008), the G-30 (2009) and the CRMPG (2008). Public authorities have continued to rely heavily on private sector institutions in all the reforms mentioned above and in the many areas of private governance that they left relatively untouched.

Overall, private governance retains a surprising degree of legitimacy despite its catastrophic failures during the crisis. Our assemblage approach and our emphasis on linkages, market practices and infrastructures fit well with this outcome. The legitimacy of private governance is not solely reliant upon skilful propagandizing by large financial associations and firms. Much more important is the densely complex and interconnected character of private governance mechanisms, extending from large associations such as the IIF through daily practices in particular firms, such as the calculation of risk exposures in banks. These create an integrated system that produces benefits, like financing of economic growth, that are difficult to detach from costs, such as risk management failures. The anchoring of this system in vastly extended sets of technical practices and objects makes it appear as if it operates beyond human control, even if humans have painstakingly constructed the system.

This helps underscore the lessons that private governance in finance can provide with regard to players, power and paradigms. The relevant players are not only large prominent players directly involved in transnational governance, but also smaller players engaged in routine daily activities. Power does not only involve the strategic deployment of resources of autonomous actors, but also the creation of linkages that align the activities of diverse sets of actors and objects, even if these are not fully aware of the powerful effects their linkages are creating. This is similar to the notion of structural power, except that it is more deliberately constructed, even if actors’ intentions may often be to achieve certain technical or commercial goals rather than to empower private transnational governance. The most paradigm-like feature of these arrangements is not a pre-packaged ideology that influences those involved, but rather the interconnected character and entanglement of ideas and materiality in the technical systems and subsystems that the arrangements include. These systems and subsystems elicit support and compliance because to participate in them one must conform to their rules, practices and, even, pathologies. Alternative systems must attain a dauntingly comparable scale and degree of interdependence to be viable. The ongoing extensive reliance on private governance mechanisms, despite their acknowledged dramatic failures in the global financial crisis that began in 2007, offers the most striking confirmation of these points.
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Notes
1 The euro BBALibor is created by the British Bankers Association and came into effect in 1999 as the successor to previous Libors (London interbank offered rates).
2 In 2010 some of the potential problems around microfinance became shockingly evident with widespread accounts of dozens of suicides associated with repayment difficulties experienced by poor borrowers in India (Lee and David 2010).
3 A 2009 merger proposal between DTCC (which originated in the US) and LCH.Clearnet (which originated in London) failed, in part because of European political and regulatory opposition to such a US presence in European clearing (Reuters 2009).

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The Financial Stability Board as the new guardian of financial stability

Stefano Pagliari

Introduction

The Financial Stability Board (FSB) represents the most important institutional innovation in the global economic governance architecture that has emerged in response to the global financial crisis of 2008–09. The FSB was created by the Group of Twenty (G-20) at the height of the global financial crisis with the task of urgently co-ordinating the international regulatory response to the crisis. However, rather than being a short-term fix in response to the crisis, the FSB has been given a central role in promoting international financial stability. In the words of the US Treasury Secretary Timothy Geithner, the FSB should have become a ‘Fourth Pillar’ in global economic governance along with the IMF, the World Bank (WB) and the WTO (US Treasury 2009).

However, this label overlooks the fact that the commonalities between the FSB and the other three pillars are far fewer than the elements that set these institutions apart. The FSB does not have the large staff and financial resources of the IMF and World Bank, nor the legal standing and the power to devise legally enforceable agreements of the WTO. Instead, the FSB’s mandate, internal structure and membership make this a rather unique institution in the global economic governance architecture.

How can we explain the unique nature of the FSB and the differences with other institutions that populate the existing global economic governance architecture? Whose preferences and paradigms are reflected in the evolution of the mandate, internal governance and membership of the institution? And what kind of power is the FSB capable of exercising over the different players that populate the governance of international financial markets?

These are the questions that will be analysed in this chapter. The first section will provide a historical overview of the FSB, starting from the emerging market crises of the late 1990s to the first significant revision of its Charter in 2012. The second section will explore the expansion in the tasks performed by the FSB over this period. This analysis will illustrate an evolution in the role of the FSB from being primarily a co-ordination mechanism to an institution capable of exercising a greater independent impact over global economic governance. The third section will examine different measures introduced since the beginning of the crisis to strengthen the institutional bases of the FSB in support of its growing set of tasks. Finally, the fourth sections
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will analyse the membership of the FSB. This section will discuss how the FSB has evolved from a narrow club to a more inclusive organization, and how it interacts with non-member countries.

**From the Financial Stability Forum to the Board: a short history**

While the creation of the FSB represents the primary institutional innovation in global economic governance to emerge from the global financial crisis of 2008–10, the roots of this institution can be found in the response to a previous wave of financial instability a decade earlier. The Mexican crisis of 1994 and the East Asian crisis of 1997–98 had the effect of opening an international debate over the possible reforms to the international financial regulatory architecture that had emerged since the 1970s (Eichengreen 1999).

In response to these shocks, the G-7 charged the President of the German Bundesbank Hans Tietmeyer with the task of consulting with other policymakers regarding possible arrangements to strengthen the capacity of existing national and transnational financial regulatory authorities to detect and respond to emerging vulnerabilities. The report presented by Tietmeyer in 1999 highlighted the tension between the global integration of financial markets and the continuous fragmentation along sectoral lines of the patchwork of existing international standard-setting organizations. The Tietmeyer Report also noted that, while the existing regulatory institutions were capable of monitoring the evolving risks in a specific sector, none of the existing institutions had the breadth of information to assess the evolving risks in the entire financial market: what Tietmeyer called ‘macro-prudential’ issues (Tietmeyer 1999, 3).

The Tietmeyer Report provided the blueprint for the creation of the Financial Stability Forum (FSF), which met for the first time in April 1999. The newly created body was described as a ‘club of clubs’ (Drezner 2007, 136), bringing together for the first time representatives of the most important standard-setting bodies that had emerged along sectoral lines since the 1970s (Basel Committee, International Organization of Securities Commissions—IOSCO, Committee on Payment and Settlement Systems, International Association of Insurance Supervisors, International Accounting Standards Board—IASB, Committee on the Global Financial System), as well as representatives of more formal international organizations (Bank for International Settlements, IMF, World Bank, and Organisation for Economic Co-operation and Development). Moreover, the design of the FSF also included national representation from central banks, finance ministries, and regulatory and supervisory authorities from the G-7 countries. This composition reflected the desire to bring together all the major national and international authorities in charge of promoting international financial stability, as well as to increase the political support behind their development and the implementation of international financial rules by increasing the engagement of finance ministries (Green 2011). However, the institutional design of the FSF also reflected the preferences of the most industrialized countries represented in the G-7 for a more incremental kind of reform of the existing architecture rather than the creation of ambitious new international regulatory institutions with substantive powers over domestic regulatory policies.

The contribution of the FSF in bolstering financial stability during its first decade was less significant than envisioned by its creators. One of the key initiatives launched by the FSF in its initial year was to bring order to the plethora of international standards and codes and to identify ‘Twelve Key Standards for Sound Financial Systems’, whose implementation should have been prioritized by countries all around the world. This initiative was consistent with the view prevalent among US policymakers of the FSF as a vehicle to ‘upgrade’ regulatory policies...
in emerging market countries and to foster convergence around international regulatory ‘best practices’ (Bluestein 2012, 13).

However, the FSF failed to develop adequate mechanisms to promote the implementation of its international standards. The responsibility to review the implementation at the national level of the 12 Key Standards was undertaken not by the same FSF, but rather delegated to the IMF and World Bank as part of the newly established Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSC). Moreover, this process remained voluntary, and individual countries maintained the right to veto the publication of the results of this monitoring exercise in full or in part. Over this period many of the emerging countries that were the primary target of the initiative engaged in what Walter has called ‘mock compliance’ or suppressed the publication of the results of this oversight (Walter 2008). Most importantly, the same US policymakers who had over this period urged emerging countries to subject themselves to this international review refused until 2008 to undergo the same review of their own regulatory system (Foot and Walter 2010). As Germain argues, over this period the FSF was ‘able to move no farther or faster than its most powerful member states’ in promoting compliance with internationally co-ordinated measures (Germain 2011, 52).

Besides the limitations in the capacity of the FSF to promote compliance with the existing international best practices, over this period the FSF also played a limited role in directing the international public policy agenda. In particular, other international standard-setting bodies that comprise the FSF remained reluctant to see their autonomy curtailed by the newly created institution (Donnelly 2012). Most importantly, the FSF developed only a limited capacity in developing regulatory policies on its own. At its first meeting, the FSF set up three working groups in charge of presenting recommendations pertaining to three areas of regulatory concern—international capital flows, highly leveraged institutions such as hedge funds, and the regulation of offshore financial centres. However, since this first meeting the FSF refrained from publishing additional issue-specific reports on its own, limiting its role to that of reporting on the work of other international standard-setter bodies. This passive role has been attributed to the preferences of the USA and other authorities for keeping the body as primarily a forum to promote communication and co-ordination among its members, rather than an action-oriented institution (Davies and Green 2008).

Also the track record of the FSF over this period in fostering awareness among its officials of the emergence of vulnerabilities has been put into question. The semi-annual meetings of the FSF addressed a variety of issues that have been recognized as among the major causes of the global financial crisis of 2007–10, such as the growth of off-balance-sheet vehicles, the growing signs of strain in the US housing market and the need for rules regarding the cross-border resolution of financial institutions. However, these discussions proved to be largely inconsequential, not leading the authorities comprising the FSF to depart from the dominant paradigm of the period. As one central bank governor participating in the FSF declared, while ‘members’ discussions about vulnerabilities have identified a number of different areas of concern over the years’, ‘it was not always clear how useful those discussions had proved to be’ (Bluestein 2012, 16).

Despite the shortcomings in the conduct of the FSF in the years preceding the crisis, the revelation of significant market failures in the summer of 2007 and the origin of these shortcomings across a variety of sectors contributed to bringing the FSF back to the centre of the international regulatory stage. The FSF met as early as September 2007 to discuss the implications of the market turbulence, for regulatory policies and measures could be introduced to strengthen the stability and resilience of the financial system (FSF 2007).

During this meeting, the FSF established a small senior group of central bankers, regulators and chiefs of international standard-setting bodies called the Working Group on Market and
Institutional Resilience, which played a key role in dictating the initial response to the crisis. The working group identified in its Report in April 2008 a wide range of market failures at the roots of the crisis, from the fraudulent practices in the US sub-prime market to the weaknesses in the role of rating agencies, suggesting 67 different policy recommendations. Moreover, over this period the FSF effectively directed the work of other international standard-setting bodies, national regulators and private market actors, often setting specific deadlines for the implementation of these measures (FSF 2008). The work conducted by the FSF in the early stages of the crisis was also highly influential in shaping the agenda of the G-20, which replaced the G-7 as the main political forum in response to the crisis. The recommendations presented by the G-20 leaders during the first meeting in November 2008 largely followed the road map delineated by the FSF (Helleiner and Pagliari 2009).

The valuable role played by the FSF in delineating an internationally co-ordinated response to the crisis led the G-20 leaders to revamp this body. At the G-20 Summit in London in April 2009, G-20 leaders agreed that ‘the Financial Stability Forum should be expanded, given a broadened mandate to promote financial stability, and re-established with a stronger institutional basis and enhanced capacity as the Financial Stability Board’ (G-20 2009, 1). Unlike the FSF, the newly created institution was also given a Charter detailing an expanded set of tasks and a more complex internal governance structure.

G-20 leaders also agreed at the Cannes Summit in November 2011 to ‘strengthen FSB’s capacity, resources and governance’ in order to allow the institution to keep pace with its broader range of functions. In particular, the G-20 leaders agreed to establish the FSB ‘on an enduring organisational footing’, with a ‘legal personality and greater financial autonomy, while preserving the existing and well-functioning strong links with the BIS’ (G-20 2011). The proposals identified by the FSB to achieve this goal were included in an amended Charter adopted in 2012 (FSB 2012f).

This represents a partly paradoxical outcome. As argued above, the FSF had in the years before the crisis achieved only a limited impact over the governance of international financial markets. Despite this track record, the origin of the global financial crisis in the same industrialized countries that dominated the FSF increased the urgency of negotiating an internationally co-ordinated response to the crisis and led the G-20 countries to revitalize the role of this institution. The next section will discuss more in depth the functions performed by the FSB to achieve this objective.

What role for the financial stability board?

The previous section discussed how the FSF played only a very limited role during its first decade, primarily as a result of the constraints posed by the USA and other industrialized economies dominating the institution. The shift from the FSF to the FSB has been characterized by a significant expansion in the mandate of the FSB. While in the case of the FSF the contours of its mission had been defined only in vague terms, the FSB Charter has defined in great detail the ways in which the institution is expected to fulfil its mandate of promoting financial stability. It is possible to summarize four roles played by the FSB in the governance of international financial markets in support of its mandate: (1) co-ordinating existing national and international regulatory authorities; (2) generating international regulatory policies; (3) promoting and monitoring the implementation of financial regulatory policies among its members and non-members; and (4) identifying emerging vulnerabilities and issues of concern.

First, the FSB has inherited from the FSF the role of co-ordinating the activities of the different international standard-setting bodies and national authorities. This had been identified by
the Tietmeyer Report as one of the key rationales for the creation of the FSF in 1999. The importance of the FSB in co-ordinating the activities of different international standard-setting institutions and steering them towards areas that they had not covered in the past has clearly been on display during the financial crisis. For instance, the involvement of the FSB has been important in pushing securities regulators co-ordinating through IOSCO towards addressing more extensively the financial stability implications of their policies. The FSB has also been instrumental in highlighting the financial stability implications of the use of ‘fair value’ accounting in the existing accounting standards, an element neglected by the IASB (Lombardi 2011). The participation by heads of these international standard-setting bodies in the activities of the FSB has facilitated the transmission of the priorities identified by the FSF into the activities of these institutions (Lombardi 2011).

The FSB Charter has also given the FSB a formal role in overseeing the activities of the other standard-setting bodies. Article 2 lists among the duties of the FSB to ‘undertake joint strategic reviews of and coordinate the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities and addressing gaps’. During the crisis, the FSB started to publish visual summaries of the progress made by the different standard-setting bodies in meeting the objectives and deadlines set by the G-20 (FSB 2012e). At the same time, while the Charter grants the FSB a special position in overseeing the work of other standard-setting bodies, it makes explicit that this review ‘should not undermine the independence of the standard setting process’ (Article 6.3). In sum, a clear hierarchical relation between the FSB and other standard-setting bodies has not fully emerged from the crisis, which, according to Donnelly, remains focused more on ‘communication, consensus-building, coordination’ than about ‘handing out instructions’ (2012).

Second, the involvement of the FSB in the development of international financial standards has gone beyond co-ordinating the work of other international standard-setting bodies. On the contrary, the creation of the FSB has led to the expansion of its role in directly initiating international regulatory initiatives. In particular, throughout the crisis the FSB has drafted a series of measures pertaining to issues not falling directly within the jurisdiction of any single international standard-setting institution. For instance, the FSB has drafted principles and recommendations concerning the oversight and regulation of the shadow banking system, compensation practices, data collection on international financial network connections, consumer finance protection in the area of consumer credit and many others. Moreover, the FSB has taken a leadership role in tackling the problem of banks that are ‘too big to fail’, identifying those financial institutions that qualify as systemically important financial institutions and co-ordinating the development of international measures to strengthen the regulatory oversight of these institutions. These standards and recommendations have often been developed together with other international economic institutions, such as the IMF, the World Bank, the OECD and the BIS, as well as with private market participants that have been involved in the standard-setting work of the FSB through consultations and private sector task forces.

While at the beginning of the crisis the FSF/B was primarily operated as a convening forum, co-ordinating the work of other international standard-setting bodies, during the crisis the number of standards and recommendations developed directly by the FSB came to rival the output of other standard-setting bodies. The growing importance of the FSB as a standard-setter has also been formalized in the FSB Charter. In particular, Article 2.3 introduced in the FSB Charter in 2012 highlights this role by affirming that the FSB should ‘develop or coordinate development of standards and principles … in areas which do not fall within the functional domain of another international standard setting body, or on issues that have cross-sectoral implications’ (Article 2.3).
Third, the FSB has also expanded its influence over the domestic implementation of these international standards. As argued above, this was one of the main weaknesses of the FSF in the years before the crisis. The creation of the FSB has led to a formalization of the commitment of the FSB members towards implementing the international financial standards and disclosing their level of adherence (FSB 2010). The FSB Charter lists implementing financial standards and undergoing an assessment under the IMF–World Bank Financial Sector Assessment Programme (FSAP) among the conditions for membership. By January 2010 all FSB member jurisdictions had participated or were in the process of participating in a FSAP, including those that had refused to undergo such review before the crisis (FSB 2010). FSB members have also committed to disclose their degree of adherence to international financial standards by publishing the assessments prepared by the IMF and World Bank as a basis for the ROSCs.

The creation of the FSB has also led to the introduction of a new mechanism to monitor the adherence of its members to international standards: peer reviews. Unlike the top-down review by the IMF and World Bank, peer reviews are based on a continuous back and forth between the country being reviewed and a restricted group of experts from the countries and international institutions that comprise the FSB in an attempt to generate social pressures and mutual learning (Lombardi 2011). During the first few years of its existence, the FSB conducted a number of ‘thematic’ peer reviews to assess the implementation of different internationally agreed standards across its membership, starting from the implementation of the ‘FSB Principles for Sound Compensation Practices’. The FSB also introduced a mechanism for individual countries to address specific compensation-related complaints by firms that document a competitive disadvantage as a result of the inconsistent implementation of the Principles and Standards by firms headquartered in other jurisdictions (FSB 2012d). Besides these thematic peer reviews, the FSB has also conducted a number of country peer reviews, monitoring the compliance of specific members with a wide range of international commitment. Mexico was the first country peer reviewed by the FSB in September 2010, followed by Italy, Spain, Australia, Canada and Switzerland during the following year.

The FSB has also regularly updated the G-20 regarding the state of the implementation of the commitments among its members. In particular, the FSB identified in October 2011 those areas perceived as most critical for global financial stability and made these subject to more intensive monitoring and reporting of implementation progress on a country-by-country basis, reporting on implementation progress in each of these areas at least once a year (FSB 2011a).

It is important to note how the involvement of the FSB towards monitoring and promoting compliance with its international standards has also extended to countries that are not FSB members. At the time of the creation of the FSB at the London Summit, the G-20 leaders called for the creation of ‘a toolbox of measures to promote adherence to prudential standards and cooperation with non-cooperative jurisdictions’ (G-20 2009, 5). In response to this request the FSB announced a ‘balance of positive and negative measures’ directed towards non-member countries (FSB 2010, 4). Among the positive incentives, the FSB announced its intention to engage in dialogue with those jurisdictions where there is weak evidence of adherence to the standards and to develop capacity-building mechanisms. In case these incentives failed, the FSB envisioned as part of its tool kit the option of publishing the names of ‘non-cooperative jurisdictions’ that failed to co-operate with the evaluation process and had demonstrated weak compliance with the main standards. However, the initial review of 61 jurisdictions singled out only two jurisdictions (Venezuela and the former regime in Libya) as in danger of sanctions as a result primarily of their refusal to engage with the FSB (FSB 2011b).

Fourth, the FSB has also been granted an explicit role in monitoring vulnerabilities in the financial system, as well as advising on the implications that these market developments may
have for regulatory policies. Following a request from the G-20, the FSB has developed together with the IMF ‘Early Warning Exercises’ to proactively identify potential systemic financial vulnerabilities and incipient risks. A division of labour has emerged between these two institutions, with the FSB leading the work on vulnerabilities and regulatory challenges in the financial sector and the IMF leading on the analysis of macroeconomic and macro-financial vulnerabilities (IMF 2010).

More generally, the FSB has been instrumental in drawing attention to the risks posed by recent trends and innovations, such as in the case of its note on financial stability issues emerging from exchange-traded funds, and therefore contributing to expand the international agenda (FSB 2011c). According to the Charter of the FSB, this review of vulnerability affecting the global financial system should occur ‘within a macroprudential perspective’ (Article 2.1), in contrast to the focus on the health of individual institutions that has characterized the work of other standard-setting institutions that comprise its membership.

The discussion of these four roles played by the FSB signals a significant expansion in the role envisioned for this institution in the global economic governance architecture compared to its predecessor body, the FSF. Moreover, the architects of the FSB have tried to strengthen the capacity of this institution to effectively address new challenges that may emerge from the evolution of the financial system. In this regard, the FSB Charter has envisioned that the institution would be allowed to ‘undertake any other tasks agreed by its Members in the course of its activities and within the framework of this Charter’. However, as the rest of the chapter will discuss in more detail, the capacity of the FSB to react to new external challenges remains constrained by its internal governance structure and the preferences of its most powerful members.

The governance of the Financial Stability Board

How well equipped is the FSB to carry forward the expanded mandate described in the previous section? Despite the significant expansion in the mandate assigned to the FSB by the G-20 leaders, the institution continues to fall short of other international economic institutions regarding the policy levers at its disposal to perform the tasks assigned.

The FSB has been given a very limited staff of around 20 employees. While this represents more than twice the number of people that staffed the FSF in the years before the crisis (Bluestein 2012), the number pales in comparison to organizations such as the IMF and World Bank, whose work is supported by a staff of respectively 2,400 and 9,000 employees (Lombardi 2011). Moreover, the size of the staff is not the element that sets the FSB apart from other international economic institutions. Unlike the WTO, the FSB is not the product of an international treaty. While its Charter lays out a precise set of commitments that the members should follow, this document does not create any legal obligation for its members, as stated explicitly in the FSB Charter (Article 16). As a result, the agreements reached within the FSB do not have the force of international law, and power to impose sanctions for non-compliant countries resides in its member states rather than in the FSB (Donnelly 2012).

The intention of the architects of the FSB to preserve the member-driven nature that characterized the FSF is clear from the FSB Charter. The Charter has identified the ‘sole decision-making body’ in the FSB Plenary, that is, the body bringing together all the national representatives that comprise the membership of the FSB, as well as the representatives of the different international standard-setting bodies, the IMF, the World Bank, the BIS and the OECD (Article 9). The Plenary remains in charge of approving the work programme and the budget of the institution, as well as of adopting standards, reports, principles and recommendations developed by the FSB.
However, unlike the Executive Board of the IMF, members of the FSB Plenary have no voting shares, and the Plenary operates on the basis of the consensus rule (Moschella 2013). The consensus rule has been presented by different commentators as one of the factors potentially hindering the capacity of the FSB to perform its mandate, especially since the size of the body now comprises more than 70 members (Griffith-Jones et al. 2010).

While at its core the FSB remains closer to a loose network of regulators, central bankers and finance ministries than to a hierarchical international organization, the establishment of the FSB has led to a number of institutional innovations in support of its expanded mandate. Four are particularly relevant: the Chair; the Secretariat; the Steering Committee; and the Standing Committees and Working Groups.

First, a central role in steering the organization is played by the Chair. This figure not only presides over the Plenary, the Steering Committee and the Secretariat, but it is also the external face of the entire organization. The Chair is appointed by the Plenary among its members for a term of three years that can be renewed only once on the basis of his or her ‘recognized expertise and standing in the international financial policy arena’ (Article 21). Mario Draghi, former head of the Italian Central Bank, was the inaugural chair of the FSB, followed in 2011 by the former head of the Bank of Canada, Mark Carney. However, despite the relevance of the position, the chairperson of the FSB maintains a ‘dual’ role, serving the FSB only on a part-time basis, not being an employee of the FSB and not earning any remuneration (Lombardi 2011).

Second, in contrast to the FSF, the FSB has been granted a larger permanent Secretariat to support the activities of the FSB and to manage its financial, material and human resources. The Secretariat is directed by a Secretary-General and hosted at the Bank for International Settlements in Basel. The staff of the FSB is primarily on temporary secondment for quite short periods from the staff of national central banks that comprise the membership of the FSB or from the Bank of International Settlements, and it continues to be paid by these organizations or the BIS, rather than being employees of the FSB itself (Griffith-Jones et al. 2010).

Third, while the Plenary is the ultimate decision-making body, the primary responsibility for managing the agenda between Plenary meetings is carried by a newly established Steering Committee. This Committee has been created to ‘monitor and guide the progress of the FSB’s ongoing work’, as well as to ‘take forward, after consultation and consistent with the directions of the Plenary, any other work necessary for the FSB to fulfil its mandate’ (Article 12).

Fourth, the Plenary has been given autonomy to set up a variety of technical committees in support of its mandate. The FSB initially created three Standing Committees. The first is the Standing Committee on Assessment of Vulnerabilities, tasked to monitor vulnerabilities in the financial system and to issue Early Warnings. The Standing Committee for Supervisory and Regulatory Cooperation has been given the responsibility of addressing co-ordination issues that could emerge among the different members of the FSB as well as to direct standard-setters towards addressing whether new standards are required. Finally, the Standing Committee for Standards Implementation has been given the responsibility to plan peer reviews and report on the progress in implementing the international standards endorsed by the FSB. Besides these Standing Committees, the FSB has also established a number of ‘working groups’ to support the Standing Committees in performing its mandate, such as the Analytical Group on Vulnerabilities, the Working Group on Experience with Peer Reviews and the Cross-Border Crisis Management Group, or to address specific issues on the agenda of the FSB, such as the Task Force on Shadow Banking, the OTC Derivatives Working Group or the Consumer Financial Protection Consultative Group.

Finally, the FSB established in 2012 a new Standing Committee on Budget and Resources (Article 17) in charge of assessing the resources required for the Secretariat to perform its
mission, review the budget and identify mechanisms to improve the transparency of the FSB’s financial governance. The establishment of this committee reflects the attempt to meet the goal set by the G-20 leaders in 2011 to strengthen the FSB’s capacity and resources, and to establish the institution ‘on an enduring organisation footing’ (FSB 2012f). One of the tasks assigned to this Standing Committee is to ‘identify, evaluate and recommend to the Plenary options for independent raising of resources by the FSB, over the medium term, to supplement the funding received from the BIS’ (Article 17.3).

These changes certainly fall short of the transformation of the FSB into a treaty-based international organization subject to international law and capable of exercising influence independently of its members. There continues to be little support among the FSB members for this kind of solution, as well as for creating more compulsory mechanisms to enforce compliance similar to the model of the WTO’s dispute settlement panels (Lombardi 2011). On the contrary, the FSB members have remained committed to the old model by stating that the organization should remain a ‘member-driven’ organization and its ‘decision making on policy issues should continue to be based on consensus’ (FSB 2012f). From this perspective, while the transformation of the FSF into the FSB has been characterized by the development of new policy levers to perform its mandate, it is debatable whether this shift has led to a transfer of power from the key stakeholders to the organization.

The membership of the FSB

The changes in the mandate and in the internal governance of the institution analysed in the previous sections are not the only transformations that have followed the establishment of the FSB. Another key difference between the FSB and its predecessor body can be found in their respective membership.

At the time of its creation in 1999, the FSF was characterized by a geographically narrow membership that was confined to representatives from the same G-7 countries that had created the institution. The Tietmeyer Report had suggested that a ‘small number’ of countries may be added to the original membership over time (Tietmeyer 1999). In the following years, the FSF expanded its membership to include Australia, Hong Kong, the Netherlands, Singapore and Switzerland.

According to the primary architect of the FSF, Hans Tietmeyer, the limited size of the Forum was necessary in order to ‘permit an effective exchange of views and the achievement of action-oriented results within a reasonable time-frame’ (Tietmeyer 1999, 5). Similarly, the first Chairman of the FSF, Andrew Crockett, argued that the institution may be more effective if its membership was ‘homogenous’ (Liberi 2003, 573). However, the preference of the G-7 countries for ensuring their control over the international financial agenda has also been presented as a key reason for the narrow membership (Drezner 2007). As a result, in the first decade of the FSF, the involvement of the main emerging markets and developing country representatives in the activities of the institution was limited to ad hoc working groups.

The outbreak of the global financial crisis in 2007 set in motion important pressures to broaden the range of countries involved in reforms of global finance. The decision by the Bush Administration in November 2008 to call for a G-20 Summit for the first time at the leaders level, in order to co-ordinate a political response to the crisis, provided the main emerging market governments with a platform to voice their discontent regarding the limited membership of the FSF and other financial regulatory institutions (Bluestein 2012). Their demands for an expansion in the membership of the FSF and other standard-setting bodies were welcomed in the Communiqué released by the G-20 leaders, which stated: ‘The Financial Stability Forum
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(FSF) must expand urgently to a broader membership of emerging economies’ (G-20 2008). When the Charter of the newly created Financial Stability Board was announced in April 2009, it included in the FSB membership not only representatives of the countries already part of the FSF but also representatives from all the other G-20 members.

Similarly to the FSF, the different countries are not equally represented within the Plenary. On the contrary, each country is allocated a number of seats on the basis of its size, the size of its financial markets and its national financial stability arrangements (Article 11). The G-7 countries each maintain three representatives in the Plenary, including a member from their central bank, a representative from their treasury or finance ministry, and a member from their financial regulatory authorities. The so-called BRIC countries were successful in achieving a similar status. Australia, Mexico, the Netherlands, Spain, South Korea and Switzerland were granted only two representatives, while Argentina, Hong Kong, Indonesia, Saudi Arabia, Singapore, South Africa and Turkey have instead only one representative. The expansion in membership has involved not only the FSB but also the different standard-setting bodies that comprise its membership (Basel Committee, the Technical Committee of the IOSCO, the Committee on Payment and Settlement Systems and the IASB), which have over the same period revised their membership to enhance the representation of developing countries.

The attempt to rebalance the geographical representativeness of the institution is not limited to the membership of the Plenary but also to the staff, that according to Charter of the FSB should ensure ‘a balance composition in terms of geographic regions’ (Article 22.5). Moreover, while the FSF used to report to the G-7 finance ministers and central bankers, the FSB is now formally accountable to the G-20, regularly reporting to, and receiving instructions from, this forum.

While these steps have certainly strengthened the representativeness of the FSB compared to its predecessor, the FSB still lacks the legitimacy that derives from the kind of quasi-universal membership of institutions such as the IMF and World Bank. The fact that a vast majority of developing and emerging countries continue to be excluded from the FSB membership is at odds with the renewed focus on promoting compliance with its financial regulatory standards among non-members. Different proposals have been presented to more closely align the FSB with the quasi universal membership that characterizes these institutions, for instance by creating an IMF-style constituency system or making the FSB accountable to a body with universal membership rather than the G-20 (Helleiner 2010).

In contrast to these proposals, the FSB has adopted a different approach, strengthening the practice already adopted by the FSF of inviting officials from non-member countries into ad hoc meetings (Bluestein 2012). The FSB Charter has institutionalized this ‘outreach’ by granting the FSB Chair the authority to extend ‘ad-hoc invitations’ to representatives of non-FSB Members to attend the Plenary Meetings and to participate in the activities of the working groups established by the FSB Standing Committees (Article 10.3).

Moreover, in the revision to the Charter introduced in 2012 the FSB has endorsed the creation of ‘Regional Consultative Groups’ comprising both representatives from FSB members and non-member countries from different regions (Article 20). The six groups initially created bring together officials from the Americas, Asia, the Commonwealth of Independent States, Europe, the Middle East and North Africa, and Sub-Saharan Africa. A total of 65 non-member countries have been included in these regional groups. Each group is co-chaired by a non-member and a FSB member, both from the region, who are chosen respectively by the non-members and by the FSB members in the group. Regional Consultative Groups were designed with the intention of providing a mechanism for FSB members to discuss with non-FSB members the different initiatives underway and to promote implementation of FSB policies, but
also for non-FSB members to share their views on vulnerabilities affecting the financial system and possible policy responses. The FSB member chairs of the Regional Consultative Groups presents the views of the group to the Plenary and members of the regional groups are invited to propose issues to be discussed by the Plenary.

Moreover, the discussion occurring within the Regional Consultative Groups should feed into the agenda of the FSB via the FSB Review Group, a group comprising FSB members and the co-chairs of the Regional Consultative Groups. This group has identified a set of financial stability issues and recent regulatory reforms, whose potentially adverse impact on emerging markets and developing economies has been analysed more in depth by the FSB in co-ordination with the IMF and World Bank (FSB 2012a).

While the agenda of the FSB during the crisis has primarily reflected the concerns of those industrialized countries that had dominated the agenda of the FSF, the creation of regional groups has created a platform for other countries to express their priorities on international financial regulatory reforms. The agenda of the first meeting held by each of the six groups between the end of 2011 and the beginning of 2012 has reflected in different cases concerns that are typical of these regions. For instance, both the Asian and the Sub-Saharan African Regional Consultative Group have discussed risk of spillover for the region from the sovereign debt crisis in Europe, and the policy options for reducing the volatility of capital inflows and the development of domestic capital markets (FSB 2011d; FSB 2012b). The Regional Consultative Group on the Middle East and North Africa has discussed the challenges faced by host-country authorities in the regulation of international financial institutions and the development of domestic capital markets (FSB 2012c).

In a nutshell, while non-member countries continue to be excluded from the formulation of international standards to which they are expected to comply (Lombardi 2011), these initiatives have opened new channels for developing and emerging countries to formulate and voice their priorities. The extent to which these different channels that have been opened for developing and emerging countries will translate into real change in the agenda of the FSB will play a key role in influencing the legitimacy of the FSB and its aspiration to act as a truly global economic governance institution.

Conclusion

The analysis of the FSB presented in this chapter has detailed a growth in the role and effectiveness of the institution from being primarily a weak co-ordination mechanism among national and international regulatory authorities to an institution capable of exercising a greater independent impact over global economic governance. The wide set of tasks detailed in the FSB Charter, the different institutional arrangements that have been introduced in support of these tasks and the greater legitimacy that derives from the expanded membership all represent important improvements in the capacity of this body to effectively promote financial stability and close emerging regulatory gaps.

On the other hand, this analysis has highlighted numerous elements of continuity with the FSF that may weaken the effectiveness of the FSB in the future. First, similar to the FSF, the FSB still remains a member-driven organization. This means that the capacity of the FSB to achieve regulatory change remains constrained by the preferences of its more powerful members and their capacity to reach a consensus. Despite the success in steering the international regulatory agenda during the crisis, the institution continues to lack significant enforcement capability of its own, and its capacity to promote compliance among its members and non-member institutions remains largely untested. Second, while the expansion in the membership of the
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FSB and the incorporation of the main emerging countries has addressed one of the most important legitimacy issues undermining the FSF in the years before the crisis, it is not clear yet how the FSB will be able to reconcile the expanded membership with the consensus-based decision-making process that governs the institution. Third, despite the expansion in membership, the FSB still remains a 'club' that excludes from its membership the large majority of developing and emerging market countries. The capacity of the FSB to reconcile the limited membership with the objective of promoting stability in global financial markets, and to promote regulatory change in the countries that are excluded from its membership, remains another important question mark. As a result, the capacity of the FSB to effectively function as a ‘fourth pillar’ in the global economic governance architecture and to avoid the fate of the FSF will be severely tested in the years after the crisis.

References


The Financial Stability Board


The International Monetary Fund’s evolving role in global economic governance

Stephen C. Nelson

The International Monetary Fund (IMF) is central to governance of the international financial system. It has long been recognized that the IMF possesses greater resources and authority than other international organizations. When Randall Stone called the IMF ‘the most powerful international institution in history’ (2002, 1) he echoed sentiments expressed by Cheryl Payer 30 years prior: ‘the International Monetary Fund is the most powerful supranational government in the world today’ (1974, ix). The IMF’s power—like that of any actor in world politics—has both material and social sources. Aside from perhaps one state (the USA) and one supranational organization (the European Union—EU), there is no other governmental or intergovernmental player that can match the IMF in terms of command of material resources. From January 2002 to October 2012 the Fund made US $615,500m. available to member states in economic distress.

An institution’s power is durable when material might is coupled with the belief, shared by other relevant actors in the institution’s external environment, that the exercise of power is legitimate (Reus-Smit 2007, 61). Legitimacy implies that the rules, principles, rights and obligations set by the institution are congruent with what the actors in that institution’s environment believe these elements should be; in other words, they perceive that the institution ought to be obeyed (Hurd 1999, 381). The IMF’s legitimacy rests on the collection of 2,000 experts, the majority toting PhDs in economics from prestigious universities, gathered within the walls of its building on 14th and G Streets in Washington, DC as well as the ability of the IMF to act as an interlocutor between the international financial community and national governments.

Since the crisis in the American financial system went global in 2008, the IMF has been resurgent. Of the $615,000m. disbursed since 2002, 85% of that sum accrued after 2008. A handful of wealthy European countries (Ireland, Greece and Portugal) are currently under conditional IMF programmes—a position that the institution has not found itself in since the late 1970s. This was an unexpected turn for the Fund. In 2005 the economist Barry Eichengreen compared the IMF to a ‘rudderless ship adrift on a sea of liquidity’. By 2007 interest payments on outstanding loans—the institution’s lifeblood—had all but dried up. The IMF’s Executive Board announced plans to trim the institution’s staff by 15% and to sell a portion of its gold holdings just to stay solvent. In the wake of the IMF’s mismanagement of the East Asian
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financial crisis in 1997–98, developing countries self-insured by accumulating huge quantities of foreign reserves. The institution was moving at an advanced rate down a path to irrelevance.

The IMF’s resurgence during a period of economic turmoil frames the questions upon which this chapter focuses. How does the IMF govern the international financial system? Has the IMF changed since 2008? Do the changes explain the institution’s resurgence? If not, what accounts for the persistence of the IMF’s power?

The IMF is a capacious organization, and conditional lending is just one of its varied activities. Article IV of the IMF’s founding charter empowers staff members to conduct annual check-ups with member countries. ‘Surveillance’, which initially focused solely on the appropriateness of the member state’s exchange rate regime, now encompasses many aspects of the economic policy environment, and since 1997 a majority of members have agreed to make their surveillance reports public. The IMF has pushed for harmonization of data standards to ensure that the economic data released by member states to interested private actors are comparable and reliable (Mosley 2003). The IMF devotes substantial resources—over 15% of the administrative budget in the late 1990s—to providing ‘technical assistance’ to member countries (Boughton 2012, 241). Further, membership in the IMF (which currently stands at 188 countries) involves obligations, the most important of which is the commitment made by members to refrain from enacting restrictions on cross-border transactions that affect their current accounts (Broome 2010a; Nelson 2010; Simmons 2000).

These are all important instruments through which the IMF orchestrates relations within and among states and market actors. However, in this chapter, I focus on conditional lending. The provision of money, conditional on the achievement of pre-specified policy adjustments hashed out by staff members and the borrower’s policy team, is the primary instrument enabling the IMF to fight crises that threaten the stability of the global financial system. It is, not coincidentally, also the reason why the IMF is a rather unloved (to put it mildly) institution. An institution that requires borrowers to undertake painful policy changes will never win a popularity contest, but the IMF’s problems may run deeper. In the years before the global financial meltdown, many observers diagnosed the IMF as suffering from a legitimacy crisis (Seabrooke 2007). ‘Crisis’ implies that the perception of the institution’s efficacy or the rightfulness of its rules, principles, rights and obligations ‘declines to the point where the actor or institution must either adapt … or face disempowerment’ (Reus-Smit 2007, 158). The IMF’s resurgence since 2008 indicates that it successfully adapted, thereby averting the marginalization that is the natural resolution of a legitimacy crisis. Yet I argue in this chapter that adaptation has been limited, at best. This suggests a misdiagnosis: the IMF was not in the throes of a legitimacy crisis. For all its problems—the chequered record of its lending programmes chief among them—it has been, and will remain, essentially the only game in town when global financial markets enter, as they have regularly over the past 30 years, a state of turmoil (Reinhart and Rogoff 2009).

The evolution of conditional lending

The IMF is the product of the plan, spearheaded by American and British officials, for a more open international economic system in the wake of the World War II. John Ruggie (1982) described the social purpose at the core of the Bretton Woods system as ‘embedded liberalism’. By this he meant that the key players (the USA, Western Europe, and a suite of international organizations including the IMF, the World Bank and the General Agreement on Tariffs and Trade—GATT) encouraged the removal of constraints on markets insofar as market forces did not impede or disrupt states’ capacities to pursue their own social goals. One of the obligations
of IMF membership, built into the Articles of Agreement, was the removal of restrictions that prevent firms and citizens from accessing currency to conduct cross-border transactions that fall under the current account. By encouraging international trade, the IMF created the demand for the thing that it supplied—resources to help states with balance of payments problems adjust without resort to exchange restrictions. In an open international economic system states can run current account deficits by borrowing from the rest of the world. However, deficits are not sustainable indefinitely. They hinge on the willingness of the rest of the world to plug the gap between what a state’s citizens consume and the domestic resources that can be mobilized to finance that level of consumption. If the capital inflows that finance the current account deficit dry up, a state finds itself in a payments crisis. Its citizens will have to cut back, perhaps drastically, on their consumption, and it will have trouble paying off maturing debt that had been issued in the years before the crisis. This dynamic posed a threat to the two elements at the core of the embedded liberal regime: (1) states would have to forego full employment and suffer deep recessions if they fell into payments problems, and (2) they would be tempted to pass the costs of adjustment onto other states by erecting trade barriers and using currency devaluations to make their exports more internationally cost-competitive.

The purpose of the IMF was to make liquidity available to members in order to smooth the adjustment process. Borrowers could stay current on their payments without having to make radical, socially disruptive policy changes to free up resources. If IMF officials thought that the member’s balance of payments problems were likely to be protracted they could approve a revaluation of the country’s currency (from 1945 to 1971 currencies were pegged to the US dollar, which was itself pegged to gold at the rate of $35/ounce).

Conditionality did not become an official part of the IMF’s toolkit until the 1960s. An amendment to the Articles of Agreement in 1968 codified the practice which developed in the previous decade: when a member’s drawings were small (relative to the amount that the member deposited with the Fund as its ‘quota’) the loan would be free of conditions, but loans in the ‘upper tranches’ (above 25% of quota) would be released in segments, conditional on the observance of policy targets agreed upon in advance by the IMF’s economists and the authorities in the borrowing country (Barnett and Finnemore 2004, 57–58). There are several possible rationales for conditionality in IMF programmes. One interpretation is that conditions provide the means through which the IMF, acting as the agent of US Treasury officials, Wall Street bankers and hedge fund managers, remakes the borrower’s economy to bring it closer to the principals’ preferred model (freer markets, less state involvement in the allocation of goods and resources) (Crotty and Lee 2009; Graeber 2011, 2; Payer 1974). Others invoke the role of the financial community but treat the IMF as an autonomous actor with its own interests. In Mark Copelovitch’s (2010) approach, the IMF’s key policy goal is catalyzing the flow of capital to needy borrowers. Conditions are a way for a borrowing government credibly to signal that it is serious about getting its economic house in order (Fischer 1997, 25). A third view holds that conditions enable the Fund to limit the borrower’s policy discretion, thereby safeguarding the institution’s resources. If the unwise policies that forced the government to seek the lifeline thrown by the IMF are not corrected, throwing money at the country without forcing it to adjust risks feeds a cycle of permanent crisis (Williamson 1983).

IMF programmes are controversial not because they contain conditions, but because of what those conditions entail. Conditions have to target some policy levers, but there are an almost endless number of policy areas that could be at the root of the borrower’s economic troubles. Where should the IMF staff direct their attention when they design a lending programme? A permutation of the basic national income accounting identity, found in every mainstream macroeconomics textbook, helps us understand why IMF programmes look the way they do.
At the core of the IMF’s approach to balance of payments problems is the identity describing the components of the current account:

\[ CA = S^P - I - (G - T) \]

The identity tells us that a country’s current account (CA) is simply the balance of private saving (S^P) over domestic investment (I) less the government’s budget position (spending, G, minus income (tax receipts), T) (Krugman and Obstfeld 2006, 289–90). The identity makes it clear that, in order to turn a current account deficit into a surplus (thereby switching from being a capital importer to an exporter), private and/or government saving must increase. For the IMF, the excess of government spending over income is a key driver of persistent current account deficits (which, again, can only be financed by borrowing from abroad) and hence an obvious area to target through conditions. This is why observers sometimes joke that ‘IMF’ really means ‘It’s Mostly Fiscal’ (Wolf 2005, 289). Lending programmes include measures to clamp down on fiscal outlays and, in some cases, to increase tax receipts.

Political opposition can make it difficult for the IMF to engineer changes in the current account solely through the government’s budget. In most cases the burden of adjustment is borne primarily by the private sector. Ghosh et al. (2005) reviewed 25 lending arrangements between 1995 and 2000; they found that the current account balance moved, on average, from a deficit of 3% of GDP over the three years preceding the onset of the programme to zero in the first year of the programme. Less than half of the adjustment in their sample came from the fiscal side. The bulk of the improvement reflected ‘both a decline in investment and a rise in domestic saving during the program period’ (Ghosh et al. 2005, 7).

It makes more sense to treat the current account identity as an outcome of adjustment than the route to adjustment, since each of the terms in the identity are shaped by economic policies. Starting in the 1950s a group of IMF economists, led by Jacques Polak, developed a ‘flows-of-funds’ framework that explained precisely how policies interact to generate payments imbalances; more importantly, the framework enabled IMF staff to forecast the size of the borrower’s financing needs in the near future, contingent on the extent of policy changes (Mussa and Savastano 2000, 108–15).

‘Financial programming’ is used to derive ‘the effects of fiscal policies and credit creation on the balance of payments’ (Boughton 2012, lvi; see also Barnett and Finnemore 2004, 51–56). Nearly every IMF programme over the past 60 years included limits on the growth of domestic credit.

By the late 1970s the core elements of IMF lending arrangements were in place. Binding conditions—violation of which could lead to the suspension of lending—typically ‘were limited to ceilings on credit expansion, government deficits, and borrowing; and prohibitions on current account exchange restrictions and on arrears to external creditors’ (Boughton 2012, 194). For the IMF, conditional lending was ‘applied economics in action’ (Fischer 1997). But, for others, the IMF was reading from the wrong textbook; heterodox economists maintained that the IMF’s fixation on the domestic roots of payments crises ignored the fact that countries can get into trouble because of exogenous shocks like the collapse of commodity prices (coffee in the mid–1990s, for example) or a dramatic, unanticipated rise in the cost of imports (oil in 1973, 1979 and 1991, for example). These criticisms had little effect on the content of IMF conditionality. However, the IMF did create new facilities with minimal conditions to provide quick infusions for members that faced problems due to adverse changes in their external economic environment. Demand for the new facilities was generally weak: the two Oil Facilities only survived for two years in the mid–1970s; the Buffer Stock Financing Facility (created in 1969 to help governments deal with commodity price fluctuations) was eliminated in 2000; the Compensatory and Contingency Financing Facility was never used and also expired in 2000.
The basic approach to conditionality shifted in the early 1980s. Staff members and management had come to the realization that distortions introduced by government intervention in markets often aggravated payments crises, and that macroeconomic reforms were not likely to be sustainable in the absence of deeper reforms. The IMF’s agenda swung toward promoting growth in the developing world, and staff members identified many ‘structural’ impediments bequeathed by 30 years of heavy state intervention in the economies of most developing countries. By the 1990s the typical IMF programme included structural elements—trade and product market liberalization, privatization of state-owned enterprises, banking system restructuring, securing the independence of the central bank, civil service reorganization, etc.—alongside ‘macro relevant’ targets. Structural conditions proliferated, although most remained ‘indicative’ (non-binding) targets in the loan agreements (Fischer 1997, 25). Nonetheless, the average number of binding conditions in IMF agreements climbed steadily upward in the decades after 1980. The plot in Figure 11.1, constructed from data collected by Nelson (forthcoming), displays the number of ‘performance criteria’ (the IMF’s term for binding conditionality) in 486 loan agreements signed between 1980 and 2000. Each dot in the figure marks a separate lending arrangement; when several arrangements include the same number of conditions, the dot appears wider.

The upward trend is clear from the figure, but another pattern stands out: there was a significant degree of variation in the extent of conditionality in IMF programmes in each year. Several explanations for this puzzling variation have emerged. Stone (2008) and Dreher and Jensen (2007) identify the strategic importance of the borrower to the IMF’s most powerful members (principal, the USA) as a key factor; they find that economically vulnerable but geopolitically important borrowers receive fewer conditions. Copelovitch (2010) argues that the

![Figure 11.1](image)

*Figure 11.1* Conditionality in IMF loans, 1980–2000
*Source: Nelson (2009)*
composition of the prospective borrower’s external debt is important: when creditors are numerous and scattered across the globe, IMF programmes have to be tough (and large) to prevent a rush for exits and to catalyze new lending. Nelson (forthcoming) argues that the ideational proximity between the top members of the borrower’s policy team and the IMF influences the extensiveness of conditionality. As the proportion of officials with graduate degrees from highly ranked American economics departments and/or significant work experience at the Fund or the World Bank increases, the average number of conditions falls (and the average size of the loan rises).

**IMF lending after the crisis of 2008**

At the end of 2009 the IMF was in an unusual position: its resources had actually grown during the two intervening years of turmoil and recession (by contrast, the Financial Crisis Inquiry Commission estimated that the crisis wiped out $11,000,000m. in wealth held by American households). In April 2009 the Group of Twenty Finance Ministers and Central Bank Governors (G-20) agreed in principle to expand the IMF’s coffers to the tune of $750,000m. In January 2012 the Fund, expecting additional demands as the eurozone debt crisis threatened to spread from Greece and Portugal to the much larger Spanish and Italian economies, sought further commitments to raise its war chest to $1,000,000m.

An uptick in lending during the credit crunch that followed on the heels of the chaotic bankruptcy of Lehman Brothers was predictable. Financial globalization meant that the balance sheets of banks around the world were exposed to the collapse of the American housing market; by 2007, at least $3,800,000m. of assets derived from securitized mortgages had spread around the world (Fligstein and Goldstein 2011). Governments scrambled to recapitalize vulnerable banks and to stay current on payments as capital inflows dried up and exports plummeted (the global value of exports fell by 28% ($761,000m.) between Q1 2008 and Q1 2009). At the time the IMF was one of the few actors in the international economy that could mobilize sizeable resources. Yet the IMF’s central role in global financial governance did not abate when the waters in financial markets calmed.

Figure 11.2 illustrates the biggest change experienced by the Fund in recent years. The figure tracks the relative size (total disbursement/quota) of 176 loans negotiated during the decade after 2002. It is clear that the average relative size of IMF loans skyrocketed after 2008. Indeed, the average size of the 84 loans concluded between 2002 and 2007 was 94.6% of quota; the average size of the 92 loans after 2008, by contrast, was 398.3% of quota. The difference in means between the two periods is highly statistically significant ($t = -5.67$, $p = 0.0000$).

The IMF responded to increased and prolonged demand for its resources in several ways. In 2009 the maximum amount of cumulative access for its members was raised from 300% to 600% of quota (Boughton 2012, 752). In addition to raising limits on the size of loans, the IMF has provided ‘exceptional access’ to borrowers whose needs go far above the official limit. This is not unprecedented—the IMF has in the past waived limits on loan size for ‘systemically important’ countries such as Mexico, Brazil, Argentina, Turkey, Indonesia and Republic of Korea—but the size of the recent loans, relative to the borrowers’ subscription, are by far the largest in the institution’s history. In May 2010 Greece signed on to an agreement that amounted, in total, to 2,399% of quota. A year later Portugal accepted a three-year loan that exceeded 2,300% of quota. Having burned through the initial disbursement in March 2012, Greece negotiated another three-year agreement, this time worth 2,158% of quota.

The IMF also created low-conditionality facilities to disburse funds rapidly to member states. The Flexible Credit Line (FCL), established in April 2009, is intended to ‘shift IMF loan policy from ex post conditionality to ex ante conditionality for … states that have a good track record of policy implementation under IMF reform programs and strong economic fundamentals’
Members that pre-qualify for access to the FCL do not face conditions. A second new facility, the Precautionary Credit Line (PCL), sets a lower bar for pre-qualification but includes light conditionality. Like previous experiments with programmes for members suffering exogenous and temporary troubles, few members have made use of the new lending facilities (Mexico, Poland and Colombia accessed resources through the FCL; Macedonia is the only member to access the PCL).

The increase in the average size of IMF programmes after 2008 is striking. By contrast, changes in the design of lending arrangements have been subtle (some might say nearly imperceptible). The high degree of continuity is puzzling, because the perceived intrusiveness and inefficacy of conditionality was a major target for critics both within and outside the Fund in the years between the East Asian financial crisis and the crisis of 2008 (Grabel 2011, 823). In 2001 the IMF initiated a review of its conditionality policy. Representatives from low- and middle-income countries on the IMF’s governing body, the Executive Board, pushed for a reduction in the number of conditions per programme. In the wake of the review, the IMF devised new guidelines to drastically streamline conditionality, focusing in particular on the structural conditions that were often the target of borrowers’ ire. The gap between the initiative’s intentions and the observed outcome was wide. A report issued in 2007 by the IMF’s watchdog, the Independent Evaluation Office, ‘concluded that the streamlining initiative had not reduced the number of conditions’ (Best 2012, 12).

Since the crisis erupted the IMF has streamlined its lending programmes, but not dramatically: the data in the IMF’s most recent review of conditionality (covering programmes signed between 2002 and September 2011) reveal that the number of conditions per programme has
fallen since peaking in 2004—but only back to the 2002 level (IMF 2012). The evidence suggests that the crisis of 2008 was not a breaking point in either the scope or content of conditionality (Grabel 2011, 821). While the IMF’s management publicly advocated the use of counter-cyclical macroeconomic policies (lowering interest rates and increasing government spending) to boost economic output during the depths of the credit crunch in 2008 and 2009, the bulk of the programmes designed by the staff look anything but counter-cyclical: stringent fiscal measures, including limits on (or big cuts in) fiscal outlays and tax increases, were enforced in loans drawn by Iceland, Latvia, Hungary, Romania, Greece, Portugal, Pakistan, the Ukraine and El Salvador (Grabel 2011, 821–22). The IMF, in a September 2009 review of 15 post-crisis programmes, contended that enforcement of fiscal targets was more flexible than it had been in the past, with frequent revisions to loosen the conditions. The IMF report admits that this was due at least in part to more dramatic declines in output than the staff anticipated when they negotiated the terms of the programmes. It was not unusual for the IMF to loosen or even waive fiscal conditions in pre-crisis programmes; for example, the Fund granted waivers for missed fiscal targets to allow Argentina to draw down a series of loans that it signed in the 1990s, despite the fact that fiscal rectitude was integral to the success of the country’s currency board-like monetary arrangement. The Independent Evaluation Office’s report on the Argentine experience noted: ‘even though the annual deficit targets were missed every year from 1994, financing arrangements with Argentina were maintained by repeatedly granting waivers’ (IEO 2004, 4).

From the IMF’s perspective the consistency of the treatment reflects the fact that many of its patients were suffering from the same disease. The region that suffered the most severe economic contraction during the crisis was Eastern and Central Europe. Figure 11.3, constructed from the World Development Indicators, illustrates that the region’s rate of GDP growth fell by over 13 percentage points between 2007 and 2009. Not surprisingly, countries in that region were heavy users of IMF resources. Eastern and Central European countries developed very large current account deficits in the run up to the crisis. Recall that current account deficits are financed through borrowing from foreign investors. Partly on the advice of the IMF, the countries in this region had eliminated exchange restrictions and liberalized their financial systems, making it very easy for citizens (and governments) to borrow at low cost. When capital inflows dried up, these countries had no choice but to turn to the IMF—and the Fund, in turn, supplied resources conditional on policy changes intended to raise private saving and cut government deficits, thereby restoring balance in the current account. The IMF’s public proclamations notwithstanding, the basic approach to crisis resolution remained consistent:

countries that are unable to finance their external payments position on affordable terms, regardless of whether the initial source of the difficulty was fiscal excess, an adverse terms of trade shock, or other developments, would have to restore balance if they are to maintain full employment and growth.

(Boughton 2012, lvi–lvii)

The concept of ‘organized hypocrisy’, as developed by Catherine Weaver (2008) in her study of policymaking at the World Bank, helps explain the puzzle of why the IMF’s very public rediscovery of the merits of Keynesian demand stimulus during this crisis had little impact on the design of its lending programmes, which remained pro-cyclical. All institutions involved in global economic governance face conflicting demands that emanate from their external environments. However, the internal cultures of institutions impose consistency across the disparate parts of the organization. In Weaver’s framework, hypocrisy—the decoupling of talk and
action—is a rational way of bridging the gap between external demands and internal strategies of coping (2008, 31). The mouthpieces of the institution have to respond to demands put upon the institution by government officials and NGOs, but the staff members develop behaviours that are consistent with the institutional culture—and culture encompasses procedures (‘this is how we do things around here’) and principled beliefs (‘this is the right way to do things’). The clash between the two logics produces organized hypocrisy.

The crisis of 2008 punctured the market-oriented paradigm that guided economic policymaking in large parts of the world. Sophisticated market players, operating in lightly regulated markets, nearly destroyed the global financial system. Saving the system from total collapse required a dramatic reassertion of state authority in the governance of financial markets. A transnational epistemic community made up of prominent economists coalesced around traditional Keynesian policies as the way to respond to the crisis, which legitimated the renewed role of the state in governing the economy (Farrell and Quiggin 2012). Opposing counter-cyclical measures like large stimulus packages meant swimming against a swift tide. Instead, the IMF’s Managing Director, Dominique Strauss-Kahn, became an indefatigable advocate for government spending, even suggesting in November 2008 that members should contribute to a global stimulus fund worth 2% of world GDP. Henry Farrell and John Quiggin, writing on the return of Keynesian ideas after the crisis, remarked: ‘what was remarkable was not so much Strauss-Kahn’s proposal, as the nearly complete absence of dissent within the IMF, an institution which had until recently been associated with very different economic ideas’ (2012, 20). Viewed from

![Figure 11.3 GDP growth, 2000–10](source: World Bank World Development Indicators, accessed at data.worldbank.org/data-catalog/world-development-indicators)
the IMF’s evolving role

The IMF’s evolving role

the IMF’s perch, the about-face was a way to curry favour and claw back some of the legitimacy that the institution had surrendered in the previous decade. The IMF had developed a reputation for a reflexively pro-market worldview in the years before the crisis (Stiglitz 2003).

For the IMF the outbreak of the crisis was particularly embarrassing, since it had failed to warn its members about mounting risks. It endorsed the views of people like Alan Greenspan, approvingly quoting from one of his speeches in its Global Financial Stability Report: ‘increasingly complex financial instruments have contributed to the development of a far more flexible, efficient and hence resilient financial system than one that existed just a quarter of century ago’ (IMF 2006, 1).

Building the counter-cyclical turn into its lending programmes would require the IMF’s economists to jettison the core elements of an approach that it had relied upon for half a century. The gulf between the talk at the top of the institution and the facts on the ground for borrowers was striking: the post-crisis changes in the practice of conditionality were incremental at best (and ceremonial at worst). By the time Strauss-Kahn was replaced by Christine Lagarde as Managing Director, the rhetoric had already shifted away from expansionist Keynesianism and back toward teeth-gritting austerity.

Organized hypocrisy appears in the Fund’s position on structural conditionality after the crisis as well. In March 2009 the IMF announced that structural conditions would no longer be included in lending programmes as performance criteria. Performance criteria are the conditions with teeth: violating this type of condition automatically triggers the suspension of a programme (unless the Executive Board approves a waiver for the violation). Structural conditions were not taken off the table, but they were relegated to ‘benchmarks’. The enforcement of benchmarks is at the discretion of the IMF’s staff members: borrowers that miss benchmarks can continue to draw on the programme even without a waiver.

Demoting structural conditions from performance criteria to benchmarks thus appears to be a significant shift. But a closer look reveals that the change has not translated into big differences in borrowers’ experiences with IMF conditionality. Historically, few programmes included numerous structural performance criteria; in the 486 conditional loans from 1980 to 2000 examined by Nelson (forthcoming), the average number of structural performance criteria in the loans was 1.45. Given severe information asymmetries (the IMF economists working in-country know much more about the details of each case than the Executive Directors back in Washington) and the norm of unanimity that governs Executive Board voting, requests for waivers to allow programmes to continue in spite of non-compliance are almost always approved. Benchmarks are not completely toothless, either: staff members can suggest the suspension of a programme if they feel that the borrower has made insufficient progress toward meeting structural benchmarks. Structural conditions are still important elements of IMF loans. The Greek loans in 2010 and 2012 involved a number of structural reforms; benchmarks related to the privatization of US $68,000m. in state-owned assets, including the national railway company, were extremely controversial (Grabel 2011, 823). A spokesperson for the Papandreou government complained: ‘we asked them for help … not to meddle in our internal affairs’ (Hope 2011).

To this point I have emphasized the continuity in the Fund’s approach to conditional lending. In the concluding section of the chapter I will speculate on the sources of policy continuity. I wrap up this part of the chapter by noting one significant change in the post-crisis content of IMF programmes. In 1995 the IMF considered an amendment to its constitutional charter that would make full capital account liberalization a condition of membership (Abdelal 2007; Chwieroth 2010; Moschella 2009). This was the culmination of a decades-long wave of support within the institution for the removal of restrictions on the purchase and sale of currency for portfolio investments. The East Asian financial crisis prompted the IMF to back away
from the extreme position that it staked out in the mid-1990s (the proposed amendment was permanently shelved in April 1998), but few anticipated the institution’s response to the imposition of exchange controls during the crisis: it gave its tacit approval for the use of capital controls (Broome 2010b, 48; Grabel 2011, 812–20). Gallagher’s chapter in this volume gives a fuller treatment of the IMF’s position on capital controls; here I briefly assay the degree of change since the crisis.

The IMF’s role in promoting capital account liberalization should not be overstated. It leaned on member countries to remove restrictions, but rarely used the tool of conditionality to pry open borrowers’ financial systems (IEO 2005). However, it was not hesitant to condemn the use of controls by member states, most notably when Malaysia—a member that has never borrowed from the Fund—imposed restrictions during the 1997–98 regional crisis. When Iceland signed an agreement in October 2008, it had already imposed controls on capital outflows. The IMF allowed the Icelandic authorities to retain the exchange restrictions. When Latvia came to the Fund in December 2008 it too was able to maintain controls that had been imposed as part of a deposit freeze at a failing bank (Grabel 2011, 815). The Fund is far from a proponent of capital controls. Yet the institution has adapted to a changed post-crisis world by accepting that exchange restrictions (‘capital flow management measures’ in Fund parlance) are a legitimate part of a member country’s policy toolkit. New guidelines that sketch the institution’s evolving view of capital controls (use sparingly, and keep them temporary, transparent and market-oriented) emerged in July 2012.

The political economy of the IMF in hard times

In this concluding section I circle back to three factors (players, power and paradigms) identified in the volume’s introductory chapter to explain the pattern of changes in IMF lending during and after the crisis.

In 2008 the IMF’s arsenal was under US $250,000m. At the end of 2011 the total assets under management of the 10 best-performing hedge funds in history amounted to $232,000m. (Mackintosh 2012)—and even the largest hedge funds are microscopic compared to money managers such as BlackRock ($3,500,000m. world-wide assets under management), State Street Global Advisors ($1,800,000m.) and PIMCO ($1,300,000m.). Forty years of financial globalization have produced a seamlessly global pool of money, the size of which dwarfs the resources that can be mobilized by any single sovereign state or international organization. The big increase in the IMF’s resources since the crisis can thus be understood as a way to level an extremely uneven playing field. The IMF is often described as the world’s financial firefighter; it cannot be a very effective firefighter if it is armed with a squirt gun.

The IMF’s chief economist, Olivier Blanchard, acknowledged that the crisis heralds a swing of the pendulum back from markets toward the state (2012, 225). The IMF is undoubtedly an advocate for market liberalization, but its advocacy masks the fact that it steps in to prevent national and regional financial conflagrations from igniting the entire system after market players have behaved unwisely. A major threat to the IMF’s ability to carry out its mandate is the growing gulf between its lendable resources and the financing needs of its borrowers. As the global pool of money grows, the cost of borrowing falls. Cheap money enabled millions of Americans to purchase mortgages that, once home prices tumbled, they could not repay, and it has allowed governments to accumulate massive debt loads. By 2009 Greece—a country of 11m. people with an economy about the size of Massachusetts—had racked up a debt that exceeded the foreign debts of Argentina, Brazil and Mexico combined (Chinn and Frieden 2011, 187). Doubling or even trebling IMF resources is not enough in an era of financial...
globalization. The IMF can try to move from the back to the front foot and take a proactive rather than reactive approach to managing the risks of over-lending by the financial community. To do so the IMF will have to answer a criticism posed by the Australian Executive Director Michael Callaghan in discussion of the staff report on a previous crisis: ‘What is not sufficiently covered in the paper are the circumstances which resulted in the private financial community being willing to finance a growing borrowing requirement by Argentina to the point that its debt level was unsustainable’ (IMF 2003, 32).

The issue of power within the IMF is contentious. The institutional avenue for the assertion of national interest is the Executive Board. The 24 Executive Directors who constitute it are appointed by their home governments and are apportioned voting rights. Many argue that the distribution of votes fails to match the balance of material power among member states. The growing political power of the emerging markets is not captured by a formula that awards more votes to Belgium than India. After years of deadlock (mainly due to European intransigence) voting rights will be reapportioned. The scheduled shift, like changes in conditionality, is far from sweeping; in October 2012, 6% of votes were set to be transferred to low- and middle-income member states and, as a result, Brazil, Russia, India and China would then join the list of the institution’s top 10 largest shareholders (Grabel 2011, 809). As of writing the modest but hard-won shift in votes has been tabled indefinitely.

Since these changes have yet to be implemented, the redistribution of power cannot be invoked to explain the changes surveyed in this chapter. How important is the Executive Board’s vote-casting to the institution’s activities in general? Less than one might expect. It is true that some decisions—such as revising the Articles of Agreement—require an 85% super-majority to pass, which gives the USA (possessing just under 17% of the votes) a veto. However, voting on proposals for lending programmes delivered to the Board by the staff and management is informal and recorded on an up-or-down basis, and the Board almost always unanimously approves staff proposals. For this reason, meddling by powerful governments to influence the terms of IMF agreements works mainly through back channels. The limits of the Board’s influence on staff decision-making was evident in the approval in July 2009 of a loan for Sri Lanka despite official abstentions by the American and British representatives from the Board’s vote on the staff proposal. Abdelal’s (2007) study of the push for the amendment to make capital account liberalization a membership obligation illuminates the social sources of power within the institution: the most advantaged state in terms of material resources (the USA) was outmanoeuvred by representatives from a savvier and more determined member state (France). The fact that power has both material and social sources means that formal institutional changes such as the redistribution of voting rights are less consequential for the institution’s behaviour than casual observers might imagine.

Shifting power in the global economy has yet to touch the process by which the head of the IMF is selected. Developing countries have twice loudly and publicly supported non-European candidates for Managing Director, to no avail. The Russians strongly backed Czech central banker Josef Tosovsky in 2007, who was passed over in favour of Dominique Strauss-Kahn; Mexico’s Agustin Carstens and Grigori Marchenko of Kazakhstan garnered support after Strauss-Kahn’s ouster in 2011. The list of nationalities of IMF Managing Directors since 1978 is, in order, French, French, German, Spanish, French and French.

We have already seen that the crisis punctured dominant economic ideas about market efficiency. Olivier Blanchard took the following lesson from a March 2011 IMF conference on the topic of the lessons for economics from the crisis: ‘We have entered a brave new world. The economic crisis has put into question many of our beliefs. We have to accept the intellectual challenge’ (2012, 225). The clearest evidence for the displacement of old paradigms is the IMF’s
newfound flexibility on the use of capital controls. However, we should be cautious in taking
this stance as evidence for an intellectual revolution within the organization. First, the IMF’s
endorsement of capital controls is rather lukewarm. The institution does not want to return to
the 1950s when countries’ financial systems were ring-fenced by severe exchange restrictions.
Second, there is no canonical case in mainstream economics for full capital account liberalization.
The IMF-organized conference on capital controls—held before the East Asian crisis—revealed
a range of views held by top economists on the subject (Boughton 2012, 137).

The IMF is often painted as an organization dominated by neo-liberal economists hell-bent
on freeing market forces. A different perspective is that the IMF endorses financial market
openness largely because there is no widely shared alternative to the view that market actors are
rational and will not blow markets, and themselves, up. The inability to admit that markets behave irrationally is perhaps one reason why it failed to warn about gathering risks in the
American housing market and, by extension, financial system, and the European market for
sovereign debt. Heterodox views of financial markets, such as those espoused by the late
Washington University economist Hyman Minsky, had little resonance with the IMF’s staff
members (Boughton 2012, liv–lv). The IMF is slow to change, not because of the deep intel-
lectual commitments of its economists to the superiority of markets; rather, it is because the
IMF follows the first rule of wing-walking: don’t let go of one thing until you have hold of
something else. For the IMF’s economists, most with graduate degrees from highly ranked
American economics departments, there is no credible alternative to the model that ties pay-
ments problems to the excess of domestic spending over savings (Mussa and Savastano 2000,
101). In this sense it is more useful to look at the role of ‘programmatic’ ideas (‘Is the idea operationally useful to us?’) than ‘paradigmatic’ ideas (‘Is the idea theoretically sound?’) in
understanding change (or the lack thereof) at the IMF (Clift and Tomlinson 2012).

Conclusion

The global credit crunch and European sovereign debt crisis—like previous events in 1982 and
1997—revealed why the world needs a central monetary authority. The IMF’s material
resources proved useful to members during the depths of the crisis. The resurgence of the
institution is best illustrated by its involvement in the resolution of the European sovereign debt crisis.

The IMF’s partnership with the EU and the European Central Bank (ECB) has, para-
doxically, generated tensions that threaten the durability of its renewed role in financial gov-
ernance. It is a partnership of necessity. The IMF alone could not hope to fill the borrowing
gaps faced by countries like Greece and Portugal. The European institutions, on the other hand,
had the money but needed to import the IMF’s expertise and credibility with bond traders.
The relationship is now fracturing. The major fissure concerns the depth of the austerity
demanded by the so-called Troika. The IMF has been quicker than the northern eurozone
member states to recognize the growth-retarding effects of deep cuts in social spending. Big
debates in economic output threaten the sustainability of countries’ debt loads. The simple
identity for debt sustainability, drawn here from Jay Shambaugh (2012, 167–68), illustrates why
that is the case.

\[ \Delta D_t = (R_t - g_t) \times D_{t-1} + \text{primary} \]

The equation tells us that the level of a country’s debt-to-GDP ratio \( D \) is driven by the
interplay of the interest rate \( R \), growth rate \( g \) and non-interest budget deficit \( \text{primary} \).
relevance for the debate on austerity is the result that the debt burden expands when interest payments exceed the economic growth rate, even if the primary budget balance turns positive. In Greece for example, growth under the IMF–EU–ECB programme turned sharply negative; as a consequence, its debt-to-GDP ratio is projected to overshoot the IMF’s target of 120% by 72 percentage points in 2014. When the IMF released a study claiming that it and the European Commission (EC) had underestimated the negative effect of austerity on growth, the EC hit back with its own paper in which the impact of austerity on growth was downplayed (Spiegel 2012). The IMF appears willing to lighten the burden of cuts in order to restore growth; the northern eurozone members do not want the southern members that their taxpayers are financing to miss their deficit targets. The tension between the members of the Troika might pave the way for marginalization of the Fund, which, if repeated in other regions, would return the IMF to the uncomfortable position that it held in the years between the East Asian crisis and the 2008 collapse, as a peripheral player in global financial governance.

Note
1 I thank Ilene Grabel, Ian Hurd and the editors of the volume, Manuela Moschella and Kate Weaver, for helpful comments.

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12
Governing global capital flows

Kevin P. Gallagher

International capital mobility has long been associated with financial and banking crises. The Articles of Agreement of the International Monetary Fund (IMF) contain multilateral rules to govern global capital flows. For some countries, especially those in the developing world, the IMF Articles of Agreement remain the core framework under which they have autonomy to regulate cross-border capital flows. For others, these rules have been partly superseded by more recent trade and other economic integration agreements. Thus, what used to be a regime of ‘co-operative decentralization’ has become a patchwork of overlapping and inconsistent governance structures that pose significant challenges to nations attempting to regulate global capital flows for stability and growth.

This chapter traces the history of governing global capital flows and presents a framework for understanding three distinct eras in the modern governance of global capital. The framework emphasizes how power, interests, ideas and institutions interact to shape each era in different combinations to yield different outcomes. From this perspective, there are many challenges ahead for effectively governing global capital flows.

Since the demise of the Bretton Woods system, a system where regulations governing cross-border capital flows were the norm, the global community has lacked a forum for governing global capital flows. In the meantime, cross-border capital flows have increased by orders of magnitude, so much so that international asset positions now outstrip global economic output. Most cross-border capital flows occur among industrialized nations, but emerging markets with fledgling financial systems are increasing participants in the globalization of capital flows. While it is widely recognized that capital investment is an essential ingredient for economic growth, there is a growing concern that certain capital flows (such as short-term debt) can be destabilizing to developing country financial systems by causing asset bubbles, exchange rate appreciation during periods of massive capital inflows, that can be followed by sudden stops and capital flight that can jeopardize stability and growth (Ocampo et al. 2006).

There is a long history of debate over volatile capital flows and the appropriate government policies relating to them. The global financial crisis has opened a new chapter in this debate, as pro-cyclical capital flows have been characteristic throughout (Chinn and Frieden 2011; IMF 2010). Until very recently certain international financial institutions and strands of economic thinking have remained either hostile or silent to regulating capital movements, yet a number of
emerging markets have been experimenting with national and regional level responses to volatile capital flows. In the wake of the global financial crisis (GFC), international arrangements such as the Group of Twenty Finance Ministers and Central Bank Governors (G-20) and IMF are considering new roles and rules for cross-border finance as well.

Regulations to govern capital flows have traditionally been referred to as ‘capital controls’ but have also been referred to as ‘capital management techniques’, ‘capital account regulations’ and, most recently, ‘capital flow management measures’. These terms are used interchangeably in this chapter to avoid redundancy. Most analysts usually differentiate between regulating capital inflows and outflows. Moreover, measures are usually categorized as being ‘price-based’ or ‘quantity-based’ controls (Epstein et al. 2008; IMF 2011). Examples of quantity-based controls are restrictions on currency mismatches, and minimum stay requirements and end-use limitations. Many of these have been used by nations such as China and India. Examples of price-based controls include taxes on inflows (Brazil) or on outflows (Malaysia). Unremunerated reserve requirements (URR) are both. On the one hand, they are price-based restrictions on inflows, but they also include a minimum stay requirement that can act like a quantity-based restriction on outflows.

Regulations most often target foreign currency and local currency debt of a short-term nature. Foreign direct investment (except for FDI in the financial sector) is often considered less volatile and worrisome from the standpoint of macroeconomic stability. Inflow restrictions on currency debt can reduce the overall level of such borrowing and steer investment toward longer-term productive investments and thus reduce risk. Taxes on such investment cut the price differential between short- and long-term debt and thus discourage investment in shorter-term obligations. Outflow restrictions and measures are usually deployed to ‘stop the bleeding’ and keep capital from leaving the host nation too rapidly.

This chapter traces the modern history of the governance of cross-border capital flows. The regime was one of co-operative decentralization, but has emerged since the GFC as an incoherent mix of co-operative decentralization and strong international standards that may threaten the ability of nations to govern global capital effectively. Part I of the chapter discusses the Bretton Woods era. Part II examines the period from the 1970s until the Asian Financial Crisis (AFC), with part III analysing the period from the AFC to the GFC and its aftermath. Each of these sections not only traces events, but offers an analytical framework to show how power, interests, ideas and institutions together shaped each era in different combinations to yield different outcomes.

Co-operative decentralization: Bretton Woods era to the AFC

The IMF Articles of Agreement, forged at the 1944 United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, grant nations the ability to pursue their own policies to regulate cross-border capital flows. The Bretton Woods conference was envisioned to result in a ‘New Deal in international economics’, according to US Treasury Secretary Henry Morgenthau and other core negotiators at the conference (Helleiner 2011). In that vision, the meetings yielded an IMF committed to stabilizing exchange rates and reconstructing balance of payments among its members.

Under the umbrella of the IMF Articles, the regime for governing capital flows could be characterized as what Eric Helleiner and Stefano Pagliari (2011) term ‘cooperative decentralization’. Co-operative decentralization is a regime where there is interstate co-operation but across a divergence of national regulatory approaches. This stands in contrast with what they term ‘strong international standards’, which are characterized by interstate co-operation and
global regulatory convergence across national systems of regulation. The IMF Articles of Agreement are actually an example of both. The Articles set out that no country may restrict current transactions—all profits and dividends from foreign transactions must be able to flow freely and without delay among the IMF members of the world. This is enshrined in the IMF and even echoed in the World Trade Organization (WTO). A nation can only restrict current transactions if the IMF sanctions it. However, with respect to the capital or financial account, as we will see, the IMF allows for national diversity in terms of regulating capital flows and permits nations to co-operate to monitor and enforce such regulations on a multilateral basis. The distinction is this—strong international standards are universal ones that cannot be deviated from; co-operative decentralization are arrangements where nations can pursue their own national-level policies but co-ordinate them on a multilateral level. In terms of capital flows, we are living in a world of co-operative decentralization. However, that regime is very strained.

The core framers of the IMF Articles were Harry Dexter White, who represented the USA, and John Maynard Keynes of Great Britain. Both Keynes and White saw capital flows as concerning. For White the need to regulate capital flows was seen as a ‘second-best’ strategy; for Keynes capital controls were second nature (Boughton 2002). Both men saw the need to regulate speculative capital flows because of the impact that such flows could have on the policy autonomy of the welfare state and on exchange rate stability (Helleiner 1994). Although the formal Mundell-Fleming model had not yet been articulated, these economists had insight to see that the free movement of capital was not compatible with a fixed exchange rate and an independent monetary policy. The free movement of capital can throw off the ability of nations to expand and contract their economies. In such an environment, lowering the interest rate to expand the domestic economy could trigger capital flight rather than domestic investment; raising rates could attract evermore capital at exactly the time when cooling off an economy is called for. Such pro-cyclical capital flows also put real pressure on the exchange rate and can cause balance of payments problems. This concern was echoed by a famous League of Nations report largely written by another well-known economist of the times, Ragnar Nurkse (League of Nations 1944).

Thus, the framers of the IMF saw capital controls as core to sustaining the international monetary system. What is more, they did not see unilateral regulation as sufficient to help nations have policy autonomy and maintain stable exchange rates. White said, ‘without the cooperation of other countries such control is difficult, expensive, and subject to evasion’ (quoted in Helleiner 1994, 38). Keynes put it this way, ‘but such control will be difficult to work, especially in the absence of postal censorship, by unilateral action than if movements of capital can be controlled at both ends’ (quoted in Obstfeld and Taylor 2004, 149). Indeed, both men articulated that nations be required to co-operate with each other’s capital controls under the auspices of the agreement. However, after fierce pushback by Wall Street interests, notions of ‘requiring’ co-operation became watered down to simply permitting such co-operation (Helleiner 1994; Abdelal 2007).

Scholars generally agree that the regime of co-operative decentralization for governing capital flows worked ‘more or less as planned’ during the Bretton Woods era, but began to break down in the 1970s (Eichengreen 2007). A large number of nations, including the USA, deployed capital controls during this period with some success. And, though in a more limited fashion than White and Keynes would have hoped, there was a certain degree of international co-operation as well (Helleiner 1994). Political power, interest group politics, and prevailing economic ideas and thinking about government all in a particular institutional setting each integrated to make the Bretton Woods era a unique period in the modern history of governing capital flows.
Kevin P. Gallagher

Table 12.1 The political economy of regulating cross-border capital flows

<table>
<thead>
<tr>
<th>Power</th>
<th>1970s to AFC</th>
<th>AFC through GFC</th>
</tr>
</thead>
<tbody>
<tr>
<td>US as ‘benevolent’ hegemon</td>
<td>US (and EU) financial hegemony</td>
<td>Multi-polarity</td>
</tr>
<tr>
<td>Interests</td>
<td>Industry-labour alliance</td>
<td>Finance-industry alliance</td>
</tr>
<tr>
<td>Ideas</td>
<td>Keynesian economic</td>
<td>New Classical economics</td>
</tr>
<tr>
<td></td>
<td>Embedded liberalism</td>
<td>Neo-liberalism</td>
</tr>
<tr>
<td>Institutions</td>
<td>Co-operative de-centralization</td>
<td>Strong international standards (OECD, etc)</td>
</tr>
</tbody>
</table>

Table 12.1 depicts how these forces interacted during the Bretton Woods era as contrasted with the neo-liberal period following Bretton Woods and from the Asian Financial Crisis (AFC) to the Global Financial Crisis (GFC). What characterizes the Bretton Woods era is that the USA was a ‘benevolent’ hegemon, that the financial sector in the USA was not as strong as in later periods, that Keynesian ideas prevailed during the period and that the world largely operated under the rubric of the IMF articles.

In terms of power, Helleiner (1994) has depicted the USA as a ‘benevolent’ hegemon with respect to capital controls. The USA permitted capital controls in other nations because of Cold War concerns. Policymakers in Japan and Europe saw controls as essential to their growth strategies, and the USA saw enabling growth and maintaining alliances with those nations as a high priority. Moreover, the USA itself deployed controls for over 10 years during the period.

It is also important to note that interest group politics in the USA were starkly different than in later periods. Domestic employment and production was the centre of US economic policy. Therefore, there was an implicit industry-labour alliance. Firms relied on aggregate domestic demand for profit and production, and therefore expansionary domestic policy unfettered by external shock was seen as being in the interests of labour and capital alike (Ferguson 1995). What is more, the entire US financial system was geared toward supporting domestic demand, and thus the financial sector also had a stake (Eichengreen 2008). Finally, investors did have the option of the Euromarket and were able to water down the requirements on co-operation in the IMF Articles (Helleiner 1994).

In terms of ideas, the construction of the Bretton Woods system reflected the prevailing mode of thought (at least in the UK and USA, where the institutions were framed) of ‘embedded liberalism’—the dominant thinking about political and economic organization at the time that stressed that markets were imperative but they needed to be ‘embedded’ in proper institutions for them to be welfare-enhancing (Ruggie 1982). ‘Embedded liberals argued that capital controls were necessary to prevent the policy autonomy of the new and interventionist welfare state from being undermined by speculative and disequilibrating international capital flows’ (Helleiner 1994, 4). This thinking was backed by a coalition of Keynesian-minded policymakers, industrialists who gained from such policy and labour leaders. Indeed, this period is seen as the heyday of the ‘Keynesian Revolution’ in economics.
The institutional backdrop for the Bretton Woods era of course were the IMF Articles of Agreement. These articles allowed for a regime of co-operative decentralization that did not live up to its full promise but did indeed operate. Nations deployed a wide variety of regulations to regulate the inflow of capital, sometimes at ‘both ends’ and sometimes in co-operative fashion.

**The push for strong international standards: 1970s to the Asian Financial Crisis**

By the 1990s industrialized countries had shifted their thinking and action on global capital flows, with most fully opening their capital accounts. These unilateral actions reflected new thinking in macroeconomics and strong financial interests that began to see capital account regulations as barriers to entry in foreign markets. Industrialized nations moved to formalize this thinking through ‘strong international standards’ on all fronts—at the OECD, at the IMF and beyond.

The results have been sweeping in the industrialized world, but only partially transforming among emerging market and developing countries. OECD nations now have a clear mandate for capital account liberalization. An attempt was also made to change the IMF Articles of Agreement to mandate capital account liberalization in the 1990s, though that initiative did not materialize.

Informally, many individual countries began advocating capital account liberalization in the 1970s, but the first formal adoption of such standards was the OECD codes. Somewhat analogous to the IMF Articles, speculative capital was initially excluded from the original (1964) codes on grounds that short-term capital would disrupt the balance of payments position of OECD members and make it difficult for nations to pursue independent monetary and exchange rate policies. The original codes were amended in 1989, when a group of nations led by the UK and Germany argued that all OECD nations by then had sophisticated enough capital markets that they could withstand liberalization of short-term flows (Abdelal 2007).

Beginning in the 1970s the IMF was transformed as well. What was once at the core of the international monetary system—regulating capital flows to maintain policy autonomy and stabilize exchange rates—began to be seen as heresy. Initially the transformation was informal, with a shift in IMF staff and board thinking, and thus a different level of surveillance and advice for member countries. In the mid-1990s the IMF proposed formally to amend the Articles of Agreement to include the liberalization of the capital account. This would have amounted to a revision of Article VI that grants nations the ability to regulate capital flows. These formal efforts did not materialize, but capital market liberalization remains a dominant view at the Fund to this day.

Although the IMF had no legal authority to force nations to liberalize their capital accounts, IMF staff and the strongest members of the board changed their thinking and began changing the advice they gave to member states during the 1970s and 1980s. According to the Independent Evaluation Office (IEO) of the IMF, the IMF did not require nations to open their capital account as part of the conditionality of a financial programme. Indeed, the IMF’s own interpretation of the Articles of Agreement is that the Fund cannot ‘require a member to remove controls on capital movements’ (IMF 2005, 31). Rather, the IMF began to encourage liberalization through letters of intent and policy memoranda that were not officially part of financial programme documents. The Exchange and Trade Restrictions department of the IMF recommended capital account liberalization in Nigeria, Guatemala, Egypt, Honduras, Jamaica and elsewhere. Joyce and Noy (2008), econometrically show that such advice was taken—between
1982 and 1998 capital account liberalization was significantly correlated with a nation having an IMF financial programme.

Revisiting Table 12.1, a confluence of factors integrated to cause one of the most decisive shifts in modern global monetary history. US foreign economic power (with the EU close by) dominated because of a mix of new-found economic ideas that tightly aligned with the emergence of financial interest groups. In parallel, the IMF became stocked with these new economic ideas and became under new management strongly committed to globalization of financial flows in the world economy. This convergence of interests and ideas gave the IMF, the USA and other industrialized countries the power to forge a set of strong international standards that replaced the regime of co-operative decentralization before it. Though many countries, at least 100, still operate under the IMF and free of these strong international standards, their position may be significantly weakened, and temporary.

With respect to interest group politics, a number of authors note the rise of a ‘Wall Street/Treasury Complex’, that came to dominate US foreign economic policy and even the IMF. Cohen (2008) illustrates that, while the costs of capital controls are directly felt by a handful of politically organized US constituents—Wall Street—the beneficiaries are diffuse and don’t feel the direct effects. Thus a collective action problem persisted where Wall Street organized around capital account liberalization. Voices as diverse as Robert Wade (1998) and Jagdish Bhagwati (2004) went on to term it a ‘Wall Street–Treasury complex’. These authors argued that the US Treasury and Wall Street investment houses pushed for the freedom of capital movements wherever possible, including forcing the IMF into pushing capital account liberalization world-wide and working to mint such a policy in the IMF Articles. Other authors such as Kirshner (2003), Blyth (2003) and Moschella (2011) see interest groups as key in shaping the change, but offer a more nuanced view of the role that interests interacted with ideas.

In terms of ideas, economic theory went through a fundamental revolution in macroeconomics, where Keynesian economics was replaced with new classical macroeconomics. These economists, later joined by ‘new’ Keynesian economists, saw capital flows as generally a good thing. This new thinking in macroeconomics formed a backdrop for a different way of thinking about government altogether—commonly referred to as the neo-liberal era, rising with the arrival of Ronald Reagan and Margaret Thatcher in 1979–80 and cresting with the ‘Washington Consensus’ advocated by the USA, Europe and the IMF throughout the 1990s. In general, this era could be characterized as seeing an extremely limited role for the state in economic affairs, and the principal role of politics was to carry out that economic view.

In the case of the IMF, Abdelal (2007) argues that this change was in part imported to the IMF from the French. French socialists were originally big advocates of capital controls. However, controls on outflows in 1983 adversely affected the middle class and led to a change in the party stance. When Michel Camdessus (a prominent French Socialist at the time) became IMF Managing Director, he met a highly sympathetic staff at the IMF and began to work together with them toward the liberalization of capital controls. Chwieroth (2010) acknowledges that the French connection was important, but stresses how the agents—the IMF staff that sponsored the prevailing economic thinking of the time—were key advocates. In its early days, most IMF staff were Keynesians who supported capital controls, but slowly the IMF became populated with USA-trained economists of the neo-classical synthesis or new classical economics who saw capital controls as counter-productive. However, Chwieroth finds that there were tensions between ‘gradualist’ and ‘big bang’ camps at the Fund. Gradualists advocated for gradual capital account liberalization and the selective use of capital controls, and big bang advocates wanted rapid liberalization of the capital account. The IMF is largely seen as a big bang advocate,
especially to casual observers who saw the IMF looking to change its charter to mandate capital account liberalization, and to those who observed IMF country programmes where capital controls often had to be eliminated on condition of an IMF loan. Chwieroth shows that this was not necessarily the case. Gradualists and big bang advocates at the IMF struck a compromise on capital controls. By the end of the 1990s the IMF was pushing for capital account liberalization but tacitly supporting limited and temporary controls as safeguard measures in crisis mitigation on the road to liberalization.

Finally, this period is characterized as a shift from embedded liberalism to neo-liberal thought in general and the dominance of a particular brand of neo-classical economics that supported a very limited role of the state in economic affairs in particular. In addition, whereas the USA and IMF had seen it as advantageous to support capital controls in the earlier era, with the Cold War no longer driving US financial strategy, the USA was now gaining a comparative advantage in global financial services and saw capital account liberalization as advantageous to key constituencies in the USA. The financial sector played a key role in US administration and the USA and EU, alongside the IMF, were able to codify capital account liberalization at the OECD and at least restrict capital controls through a number of global and regional trade and investment treaties. They were not successful, however, in making a global mandate for capital account liberalization through changes in the Articles of Agreement of the IMF.

**Regaining control? Regulating capital flows and global financial crises**

The Asian Financial Crisis (AFC) and other crises during the late 1990s in Brazil, Russia and Argentina led to a fundamental change in the way emerging market nation states came to view capital account liberalization. The IMF also tempered and clarified its institutional view on capital account liberalization and capital controls, and the G-20 played a catalytic role as well. During this period there were breakthroughs in economic theory and evidence that questioned capital account liberalization and justified capital controls. Alongside this change, however, a patchwork of global and regional trade treaties emerged that require some capital account liberalization and limit the ability to regulate cross-border finance. A hybrid regime of co-operative decentralization and strong international standards has emerged.

In response to the AFC and other crises of the 1990s, many nations sought to ‘self-insure’ from having to resort to the IMF by accumulating foreign exchange reserves and deploying capital controls (mostly on inflows). A large body of research shows that those efforts were effective in maintaining macroeconomic stability during one of the largest periods of emerging market growth in history. Moreover, newer research shows that such efforts in part explain why emerging market and developing countries were among the least hard hit during the GFC.

Many developing nations deployed capital controls between 2002 and 2007, and controls were part of the reason why developing countries were not as hard hit during the GFC. This became confirmed in a February 2010 IMF Staff Position Note. The IMF staff reviewed all the evidence on capital controls on inflows, pre- and post-crisis and concluded: ‘capital controls—in addition to both prudential and macroeconomic policy—is justified as part of the policy toolkit to manage inflows’ (Ostry et al. 2010, 5). To come to this conclusion, the IMF study reviewed the experiences of post-Asian crisis capital controls. The econometric analysis conducted by the IMF examined how countries that used capital controls fared versus countries that did not use them in the run-up to the current crisis. They found that countries with controls fared better: ‘the use of capital controls was associated with avoiding some of the worst growth outcomes associated with financial fragility’ during the global financial crisis (Ostry et al. 2010, 19). The IMF report echoed a less publicized but even more legitimate assessment of the capital controls.
literature by the National Bureau of Economic Research that concluded: ‘in sum, capital controls on inflows seem to make monetary policy more independent, alter the composition of capital flows and reduce real exchange rate pressures’. In terms of outflows, say the authors, ‘it is clear that such provisions were successful in Malaysia, but it is not so clear about the case of other nations’ (Magud et al. 2011).

As the GFC accentuated, developed nations experienced low interest rates and slow growth, while developing countries had relatively higher rates of interest and growth. This triggered a new wave of capital inflows to developing countries that caused significant currency appreciation and asset bubbles. Indeed, Brazilian President Dilma Rousseff referred to these inflows as a ‘liquidity tsunami’, as she toured the world in 2011 and 2012 pointing to developed countries to limit the outflow of capital from their nations. It is no surprise that the loudest cry came from Brazil, that experienced an over 40% appreciation between 2009 and 2011 and a stock market bubble as well. In response, Brazil has deployed numerous taxes and other limits on stocks, bonds and derivatives positions. With the exception of Brazil, the nations that have received the most attention for deploying capital controls are in East Asia. Brazil, South Korea and Taiwan have been the most aggressive in deploying controls. A number of analyses have shown that these recent efforts have also been effective, despite the fact that there has been no co-ordination or co-operation across borders during the GFC period on controls whatsoever (IMF 2011; Gallagher 2011; Forbes et al. 2011; Bauman and Gallagher 2012).

Following the AFC, the IMF took a more gradual approach to capital account liberalization and even supported the use of capital controls on some occasions. After the GFC, the IMF clarified that position with an ‘institutional view’ on liberalization and regulation, and went beyond supporting capital controls to recommending them. In 2005 the IMF’s Independent Evaluation Office conducted an assessment to evaluate and synthesize the IMF’s approach to capital account liberalization from the AFC to 2004. The IEO concluded that the IMF position began to evolve after the AFC. In contrast to the 1990s, the IMF’s policy stance on capital account liberalization can now be summarized as fully supportive of capital account liberalization. However, the Fund also recommends that the liberalization of the capital account should be gradual, and sequenced. Finally, the Fund recognizes that temporary capital controls can be a part of the transition to eventual liberalization (IMF 2010).

After the GFC, this little known change became accentuated and clarified. From the AFC until the onset of the GFC regulating capital flows was a quiet undertaking at the IMF. After the GFC struck in 2008, the IMF began to clarify their stance on capital regulation and to become fairly vocal about that view. In addition to the staff position note discussed earlier, the IMF has reiterated its support for the use of capital controls in its Global Financial Stability Report and in its flagship World Economic Outlook (IMF 2010; Grabel 2010). Whereas those reports discussed the need for regulating financial inflows, during the global financial crisis the IMF also recommended or at least sanctioned controls on outflows in Iceland, Latvia and the Ukraine (Grabel 2010; IMF 2012).

In 2010 French President Nicolas Sarkozy assumed a role as host and head of the G-20 for 2011—the period of excessive capital market volatility recently discussed here. Sarkozy saw the myriad use of capital controls and called for a global code of conduct on capital controls, and tasked the IMF to propose a set of guidelines for reform. Under this direction the IMF staff conducted research for the executive board, which formally endorsed a set of guidelines on inflows in April of 2011. Guidelines on capital account regulations and controls on outflows were drawn up in March of 2012 and discussed at the executive board in April 2012. The official IMF papers to this end were synthesized into a final document representing the fund’s ‘institutional view’ in October 2012.
The IMF’s guidelines on inflows recommend that countries deploy capital controls only as a last resort—that is, after such measures as building up reserves, letting currencies appreciate and cutting budget deficits. The Fund also recommends that controls not be discriminatory among residents. What is more, the IMF stopped referring to regulations as ‘capital controls’ and created the phrase ‘capital flow management measures (CFMs)’ in order to be more precise and to detach the stigma that comes with ‘capital controls’ (IMF 2011). Developing countries were highly concerned with the effort because it was seen as narrowing the flexibility under the Articles and leading to strong international standards. Some openly criticized the vote of endorsement, arguing that it was a vote of ‘weighted majority’, whereby industrialized countries that were the source of the capital outflows voted to restrict the ability of developing country recipients of the subsequent inflows to act upon them. No developing countries voted for the measure (Batista 2012). In the cases where the IMF econometric analyses found controls to be effective, such measures were part of a broader macroeconomic toolkit and were deployed alongside other measures—not as a ‘last resort’.

Interestingly, whereas the entire effort was supported by the French, it was on French soil where the IMF guidelines were tempered by a (non-binding) set of conclusions signed by all G-20 leaders and finance ministers. The G-20’s 2011 meeting was held in Cannes during an acute period of the eurozone crisis that captured the attention of most negotiators. However, a working group was formed to take the capital flows issue to the highest level. Headed by Germany and Brazil, the group forged the G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences. The document was endorsed by the G-20 finance ministers and central bank governors in October, and then endorsed by the G-20 leaders themselves in Cannes. The effort was spearheaded by Brazil and accepted by Germany because at the Cannes meetings Germany was seeking emerging market support to build a firewall around the eurozone to prevent further crises there. In contrast to the IMF guidelines, the G-20’s conclusions say that ‘there is no “one-size fits all” approach or rigid definition of conditions for the use of capital flow management measures’ and that such measures should not be solely seen as a last resort. Instead, the G-20 now calls on nations to develop their own country-specific approach to managing capital flows.

In 2012 the IMF pushed on with the development of its guidelines, which it initially referred to as a ‘framework’ but then became synthesized as the Fund’s ‘institutional view’. The IMF reiterates its support of capital account liberalization as a long-run goal, but slightly qualifies that support relative to the IEO assessment. The IMF now states that capital account liberalization is only optimal after a nation has reached a certain threshold of financial and economic development and (echoing its past stance, 1997–2004) that liberalization should be sequenced, gradual and not the same for all countries at all times. The IMF view is that capital controls can be part of the liberalization and sequencing. The IMF also recommends guidelines for the use of controls on capital outflows, arguing that, by and large, they should not be used but can be considered in crisis or near-crisis conditions (IMF 2012). Side by side with the IEO assessment, the distinctions between the two are subtle, but now the IMF is fairly clear about when and why it may recommend liberalization or regulation and has become much more openly vocal and transparent on the matter.

Somewhat overlooked in the literature is the fact that, by the late 1990s, industrialized countries were also effectively restricting the ability of nations to regulate capital flows by signing trade and investment treaties. Most industrialized countries granted each other market access through the General Agreement on Trade in Services (GATS), particularly the Annexes on Financial Services to the GATS, agreed upon in 1997. As later efforts toward multilateral trade liberalization have faltered, there has been a proliferation of preferential trade treaties and...
bilateral investment treaties. Many of these implicitly liberalize capital accounts through financial services provisions or explicitly do so through investment provisions.

The USA spearheaded a move to include services in global trade negotiations for the Uruguay Round (1986 to 1992). Because of the strong financial lobby in the USA, the USA particularly took the lead role in the liberalization of financial services (Hoekman and Kostecki 2009). Liberalizing financial services under the GATS or in a preferential trade agreement does not require the wholesale opening of the capital account, per se. Sydney Key (2003) says, ‘the bottom line is that if a country makes a commitment to liberalize trade with respect to a particular financial service in the GATS, it is also making a commitment to liberalize most capital movements associated with the trade liberalization commitment’. Regional and bilateral treaties, especially those engaging the USA, increasingly restrict the ability of nations to regulate capital flows as well (Gallagher 2011). Interestingly, the IMF has repeatedly urged trade policymakers to allow nations temporary derogations from trade and investment treaties to deploy cross-border financial regulations (IMF 2009, 2012).

A growing body of scholarship recognizes that financial crises often present opportunities to rethink and change—or at least reinterpret—existing institutions (Blyth 2002; Schmidt 2011). The AFC, and even more so the case of the GFC, were no exceptions. Corresponding to Table 12.1: US hegemony over global finance became countervailed by the new economic power of emerging market economies (many of whom have deployed controls); interest groups in emerging market economies often supported regulating capital flows; and responses in industrialized countries coalesced around trade and investment treaties to deregulate capital flows. In terms of ideas, an overbearing weight of econometric evidence began to show that capital account liberalization was not associated with growth and that nations using capital controls were more apt to be stable. Moreover, new developments in economic theory arose that saw cross-border finance as inherently unstable and articulated a clear rationale for regulation. In terms of institutions, on the one hand the IMF’s Articles became open to reinterpretation by nation states, the G-20 and IMF staff and board. Conversely, trade treaties limited the scope and scale of new thinking for many countries. The result is a challenge to the monetary system where, on the one hand, there is renewed flexibility and impetus for regulating capital flows and, on the other hand, there is less policy space.

Many significant emerging market countries saw unprecedented growth between the AFC and the GFC. This new-found economic power has balanced the global discussion on regulating cross-border finance. China, India, Brazil, South Africa and other nations are now part of the G-20 (which has played the key role in the crisis rather than the G-8), have (a little) voting power at the IMF and World Bank, and generally have asserted more sway, given their market power and dynamism. Many of these nations deploy controls and see them as part of preserving autonomy for domestic objectives. They have been reluctant to liberalize their capital accounts and frequently (or permanently in China’s case) deploy capital controls. These countries, to varying degrees, could be classified as ‘neo-developmental states’ or at least a hybrid version of developmental states and neo-liberal approaches that to some degree are trying to ‘re-embed’ markets (Ban 2012). Many important interest groups in emerging market nations that saw the threat of export decline due to exchange rate appreciation supported national efforts at capital controls after the GFC (Gallagher 2012).

Another factor, analogous to past assessments, is the French connection. Dominique Strauss-Kahn used the crisis to reshape the tattered image of the IMF, which had been significantly stigmatized after the Asian financial crisis. Many developing nations accumulated reserves, deployed capital controls and set up regional financial arrangements in order to avoid the IMF in times of crisis. Projecting a ‘kinder’ IMF was part of Strauss-Kahn’s objective. Many
emerging markets were deploying controls; the IMF was not about to pick a fight (Gabel 2010). Not to be out-done, French President Nicolas Sarkozy also played a key role in reinvigorating the IMF precisely on this issue by charging the Fund to formulate the code of conduct for liberalization and controls.

As was the case in the 1990s, French leadership met with staff enthusiasm at the Fund. A significant turnover occurred at the Fund since the 1990s and many ‘big bang’ liberalizers had left, especially in the highest leadership positions. Many in the staff used the mandate from Sarkozy, new economic ideas and the flexibility of the IMF Articles to reinterpret or ‘incrementalize’ IMF thinking on capital controls (Moschella 2012). Current and former staff conducted some of the more rigorous econometric analyses showing that capital controls helped stabilize emerging markets in the run-up to the GFC and helped mitigate the worst of the GFC’s aftermath (Magud et al. 2011; Ostry et al. 2010). Moreover, key staff were influenced by and collaborated with economists (some of them former senior IMF staff) who developed a ‘new welfare economics’ of capital controls.

Anton Korinek, Olivier Jeanne and others have developed a new way of thinking about capital flows and capital controls (Jeanne et al. 2012; Korinek 2011). According to this research, externalities are generated by capital flows because individual investors and borrowers do not know (or ignore) what the effects of their financial decisions will be on the level of financial stability in a particular nation. A better analogy than protectionism would be the case of an individual firm not incorporating its contribution to urban air pollution. Whereas in the case of pollution the polluting firm can accentuate the environmental harm done by its activity, in the case of capital flows a foreign investor might tip a nation into financial difficulties and even a financial crisis. This is a classic market failure argument and calls for what is referred to as a Pigouvian tax that will correct for the market failure and make markets work more efficiently. Alongside these new developments, of course, the ‘old’ economics of capital controls advocated by many post-Keynesian economists gained new ground because of the lack of credibility that emerged around new classical macroeconomics (Gallagher 2011).

The USA and interest groups representing the financial sector were ambivalent on one level and quietly against controls on another. The USA (government and financial lobbies) has not obstructed efforts at the G-20 and the IMF but has been quite vocal about not granting its trading partners the flexibility to use controls. The USA saw to it that early G-20 communiqués called for nations to allow capital to continue to flow freely across borders. However, at the 2011 G-20 summit in Seoul, the USA endorsed a communiqué in which, while not mentioning capital controls explicitly, G-20 leaders called on the IMF and others ‘to do further work on macro-prudential policy frameworks, including tools to mitigate the impact of excessive capital flows’ (G-20 2010). At the Cannes G-20 meetings in 2011 the USA was distracted by the crisis in the eurozone, while Brazil and Germany crafted the ‘coherent conclusions’ on regulating capital flows discussed earlier. In conversation with senior officials at the US Treasury Department in preparation for this paper, the US ‘lenience’ on this issue at the G-20 marks a shift from the George W. Bush Administration and shows that ‘the door is ajar on capital controls’. In February of 2011, the US Treasury Secretary was said to have tacitly endorsed Brazil’s capital controls when he said that countries such as Brazil may need to adopt carefully designed macro-prudential measures to stem inflows (Winter 2011).

On the other hand, the US government and the financial sector in many ways moved on from explicit discussion of capital account liberalization at the IMF and have taken it to the WTO and regional and bilateral trade treaties. Woll (2010) shows how a variety of firms and governments ‘reframed’ the globalization of finance into a ‘trade in services’ discourse
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that found a new home in trade and investment treaties. The financial services sector was no exception. Especially in the USA, the financial services sector pushed hard in the 1990s and early 2000s to open capital markets through trade treaties (Key 2003; Kelley 2008). In 2010 over 250 economists from across the world urged the USA to allow flexibilities so that nations could deploy capital account regulations to prevent and mitigate financial crises. In a letter to the signatories the USA stood firm, saying that other measures were more appropriate than cross-border regulations. This stance was echoed by the heads of 17 business lobby groups such as the Financial Services Roundtable, the Business Roundtable, United States Council for International Business and many others (GDAE 2011).

Summary and conclusion

This chapter traced the history of governing global capital flows and presents a framework for understanding three distinct eras in the modern governance of global capital. The framework emphasizes how power, interests, ideas and institutions interact to shape each era in different combinations to yield different outcomes. From this perspective, there are many challenges ahead for effectively governing global capital flows.

The Bretton Woods era could be characterized as one of ‘co-operative decentralization’, where an order was established that allowed individual nations to regulate cross-border finance on their own and informally co-operate as necessary. That regime worked fairly well, but a confluence of interest group politics and new economic ideas led to a push to create global regulations to require the full liberalization of capital flows. That project was partially successful at the national level but failed in terms of global governance, with the exception of provisions that limit the ability of nations to regulate capital flows under the WTO and other trade treaties. The current era began with the AFC and has led many nations and actors to rethink the role of regulating financial flows for stability and growth. A shift in economic thinking on capital flows, and the new-found economic power of emerging markets, with key interest groups supporting that power, help explain why many nations have returned to regulating capital flows in the wake of these crises. However, the current era is also characterized by the USA—and to a lesser extent the EU—trying to reassert its hegemony through the limiting of regulatory policy space for capital controls under various trade and investment treaties. What is more, there are some concerns that the new thinking at the IMF may evolve into an amendment to the IMF Articles that will require capital account liberalization but exhibit the more friendly guidelines on regulating capital flows as well.

The result is a patchwork and incoherent set of institutional structures for governing capital flows. Some nations such as Brazil operate under an order of co-operative decentralization where they are solely bound by the IMF Articles of Agreement. Other nations such as Chile have traded away that flexibility to become members of the OECD and party to trade treaties with the USA. This patchwork of institutional structures—and the political forces that support them—may make it more difficult to construct a global system that regulates cross-border finance for stability and growth. The co-existence of co-operative decentralization on the one hand and strong international standards on the other may make it more difficult for nations to co-operate effectively on regulating cross-border finance. For instance, Keynes and White stressed the need to regulate capital at ‘both ends’. However, one nation may have the legal freedom to regulate capital under the IMF at one ‘end’, but a potential co-operative partner may not be able to co-ordinate at the other ‘end’ because it may be party to the OECD or a US trade treaty.
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Note

1 The European Union formalized capital account liberalization in 1988. This essay focuses on ‘global’ economic governance spanning more than one continent.

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The governance of black holes of the world economy

Shadow banking and ‘offshore’ finance

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Introduction

Recent financial history can be interpreted as a spiral of financial and economic crises and a set of regulatory responses to them. Over the past few decades this process has shown that the global financial system is adept at establishing alternative legal and quasi-legal spaces that circumvent national systems of taxation and financial regulation. About half of the global stock of money is routed through ‘offshore’ financial centres (OFCs), many of which are considered to be tax havens. The vast majority of wholesale banking takes place in unique quasi-legal spaces of the Euromarket and its various descendants. More recently, the global financial crisis of 2007–09 has revealed the scale of the phenomenon of ‘shadow banking’ (SB), or a complex network of financial intermediation that takes place outside the balance sheets of the regulated banks, and thus remains invisible to the regulatory bodies.

In the USA on the eve of the crisis, the scale of the shadow banking industry was estimated to be one-and-a-half times larger than the ‘visible’ banking sector. In Europe, recent estimates suggest that SB practices have actually grown in scope after the crisis of 2007–09, while other studies suggest that SB has historically played an important role in the financing of the economy in emerging markets (Ghosh et al. 2012; Bakk-Simon et al. 2012). The two intertwined phenomena of OFCs and SB are drawing the attention of global and national regulators.

Analysing the two phenomena, this chapter offers a distinct contribution to the study of economic governance processes discussed in the broader framework of this volume. On the one hand, the major players shaping the regulatory discussions of ‘offshore’ and shadow banking are easily identifiable and fit well within the scope of other analyses presented here. These include the core industrialized countries—the USA, the European Union (EU), the UK and, to a lesser extent and at least for the time being, China. They are advised by research arms of their treasuries, their central banks, and other international governing bodies and think tanks, such as the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD). Consultations and debates unfold under the umbrella of established forums, including the International Monetary Fund (IMF), the BIS, the Financial Stability
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Board (FSB) and the Financial Action Task Force (FATF), but also among quasi-public bodies such as the OECD and the Group of Twenty Finance Ministers and Central Bank Governors (G-20). Importantly, the players’ area also accommodates private stakeholders of financial governance, including banks, hedge funds and international professional services companies (large accounting and law firms and a spate of specialized consultancies). Civil society organizations, such as the Tax Justice Network or Finance Watch, also play a major role. In most existing accounts of structural configurations in finance, the power of the key players and their vested interests are imputed rather than researched in depth. Yet, perhaps unsurprisingly, evidence suggests that the large banks, non-bank financial institutions and accounting and law firms seek to limit regulation, on grounds of cost, scale, efficiency, utility and so on.

Therefore, what is missing in existing analyses of financial power is a clearly defined paradigm of regulation and governance. One major reason for this is the fact that the ‘black holes’ have been largely ignored in mainstream discussions. It is notable that many key advisory and (some) regulatory bodies, such as the BIS and some research departments of the central banks have, for the time being, managed to escape to a degree the traditional political restraints that they encountered in the past. In fact, they have emerged at the forefront of research in and proposed solutions for the twin problems of tax and regulatory avoidance. Much of what is known about SB phenomena is a product of innovative work of a group of researchers, initially at the Federal Reserve, led by Zoltan Pozsar, who then moved to the IMF and is currently a senior adviser to the US Treasury. The Bank of England practically gave a free hand to Andrew Haldane for blue-sky thinking about regulation and the purpose of banking today. Claudio Borio, a senior economist at the BIS and a staunch critic of deregulated finance before the crisis, emerged as a powerful thinker in the post-crisis regulatory scene. These and other research units are behaving, for now, as is expected of them: they are relatively open minded, prepared to entertain a diversity of opinions and theoretical paradigms. However, it is unclear how long this trend will continue.

The chapter supports our earlier analysis (Nesvetailova and Palan 2010), which suggests that the so-called neo-liberal paradigm has split between private and public facets of governance. Private actors, by and large, continue to believe, or at least publicly promote, the conventional neo-liberal notions about the balance between the public and the private, the state and the market. In contrast, public governing bodies have long abandoned the neo-liberal paradigm, relying instead on a pragmatic choice of regulatory tools and, most recently, on economic stimuli that contradict the orthodoxy (McCulley and Pozsar 2013). The size and importance of ‘offshore’ and SB raises further philosophical questions concerning the legitimacy, relevance and efficiency of the solutions that are being proposed. Aggressive tax avoidance perpetrated by multinational corporations, rich individuals and banks are now high on the public agenda. The casino-like behaviour of the financial industry is a source of consternation and ridicule. Any proposal to regulate these two realms is likely to be received well. At this point, however, we cannot predict how effective the proposed solutions might be.

In the short space allowed by this chapter we can only present a sketch of the ongoing efforts for a global regime of regulation. This is partially because of the complexity of the issue, partially because the new principles and approaches to governing financial innovation are in discussion stages, with many proposals remaining as points of contention, internationally and nationally. Here it is noteworthy that, while authorities in the EU and the USA and the international financial institutions such as the IMF and the BIS have launched serious consultations on the regulation of these quasi-legal financial spaces, the attitude of China and other rising powers to these proposals remains unknown. In what follows, this chapter discusses the state of play and current plans for the governance of tax havens, ‘offshore’ finance and the shadow banking industry.
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Accounting for the black holes of the world economy

Existing debates on international financial governance tend to focus on the role of official structures and institutions in overseeing global financial stability and managing crises. Rarely do debates on governance and regulation take specific account of the so-called ‘black holes’ of the global economy, namely, ‘offshore’ financial havens and the shadow banking system. However, the statistics associated with ‘offshore’ financial hubs and the scope of shadow banking practices suggest that these financial ‘black holes’ play a central role in today’s global economy. In one way or another, about half of the global stock of money passes through ‘offshore’ jurisdictions, which is equivalent to about one-third of all global foreign direct investment (FDI) (Palan et al. 2010). Recent estimates place the amount of accumulated wealth registered in ‘offshore’ havens at about US $21,000,000 million, or at nearly 18% of the aggregate global wealth (as opposed to global gross domestic product—GDP, estimated at around $70,000,000 million) (Henri 2012).

The figures for the shadow banking industry are no less staggering. According to the data from the Federal Reserve, in 2007, on the eve of the global financial meltdown, the size of SB in the USA was US $18,000,000 million or $6,000,000 million above the volume of the regulated banking system. In the aftermath of the crisis, the volume of the shadow banking system has gone down to an estimated $15,800,000 million (Pozsar et al. 2010). Recent data from the FSB puts the size of the global SB at around $67,000,000 million at the end of 2011, or the equivalent of about half of all bank assets world-wide (FSB 2012).

The regulatory challenges posed by these quasi-legal financial spaces are enormous. Neither economic theory nor policy instruments were designed to handle these phenomena. Economic policy is designed to deal with the world as interpreted by economic theory. Yet, a world economy that consists of diverse sovereign entities, each with its own government, political systems, institutions and structures, and each having the right to write their own laws, is very different from the abstractions used in standard economics (Palan 2013). The logic of action of economic agents that inhabit the former is different, often spectacularly so, from the logic of action of economic agents that inhabit the abstract world of international economics. For instance, in the abstract world of international economics, agents maximize utility by improving their competitive position—they seek utility; improve efficiency and productivity; and search for welfare gains. In this framework, market pricing is seen as one of the most successful mechanisms of co-ordination and resource allocation that humans have ever devised. According to the orthodoxy, as systems of information, markets transmit and co-ordinate knowledge about the needs and desires of individuals as consumers, and encourage producers and service providers to respond to those needs. The financial markets, specifically, bring together two categories of financial agents: savers of capital and consumers of capital. Efficient markets, so the theory goes, ensure the most efficient allocation of capital resources between these two categories. In principle, one would want to ensure a degree of market freedom, so that economic agents can perform their tasks most efficiently. Regulations, the theory suggests, are normally designed to direct such utility-maximizing actors towards politically agreed goals.

The real world of the economy is very different. Economists, for instance, habitually argue that capitalists are in the business of maximizing profits, but they neglect to ask whether businesses are seeking to maximize pre-tax or post-tax profits. Considering that corporate taxation in many OECD countries may reach 30% or even 40% of declared pre-tax profits, this is not a trivial question. Maximization of pre-tax profits tells us nearly nothing about what businesses and, in particular, their owners and shareholders, truly care about, which is post-tax profits. Theoretically, the difference may appear marginal. It is not. The quest for post-tax profits has led to the development of a service economy with lucrative lines of business in tax and regulatory
avoidance. This service economy is run by highly skilled professionals, such as lawyers and accountants. Politically, this group of professionals has emerged as a powerful international lobby group. The business of regulatory avoidance, otherwise known as financial innovation, is now considered one of the main purposes of international finance. Regulatory bodies are only beginning to take account of these trends.

The quest for post-tax profits is linked to another important idea, or habit of thought, of mainstream tradition in political science and economics. ‘There are no free lunches’, Milton Friedman famously argued. In economics there is nothing that is ‘free’, since somebody has to pay for it. That may be true, but an alternative economic paradigm, known as evolutionary institutionalism, is predicated on the assumption that was captured by Giovanni Dosi: ‘there are always a lot of free lunches, provided you are able to discover and grab them’ (Dosi 1991, 6). In other words, there are many opportunities out there, and both opportunities and penalties are not allocated equally or democratically among people and businesses. Economic actors seeking to maximize post-tax profit might not be as concerned with improving their competitive position or raising efficiency or productivity as suggested by standard economics. Instead, they tend to spend much time and money seeking to grab any free lunches available.

To oversimplify somewhat, the rise of the ‘offshore’ world and shadow banking industry can be seen as a history of the discovery, often by accident, of opportunities for ‘free lunches’ that have existed because the world economy operates in a striated space of the state system. Regulation of such ‘free lunches’ is an exceedingly difficult problem. Regulatory paradigms have had difficulties incorporating notions of such free lunches; predictably, the impact of regulations in the financial and tax sphere have tended to produce a spate of unintended consequences. One positive aspect of current discussion is that the current debate on regulation of the two spheres aims to consider seriously such possible unintended consequences.

**Tax havens and ‘offshore’ finance**

Modern tax havens have existed since the early 20th century. They were used, and are still used, primarily but not exclusively, for tax evasion and avoidance purposes. Tax havens are used, however, for other purposes as well. Since the early 1960s, all the premier tax havens of the world have developed financial centres known otherwise as ‘offshore financial centres’ (OFCs). It is estimated that about half of all international lending and deposits originated in OFCs, of which approximately half again are located in OFCs that double as tax havens. The BIS statistics of international assets and liabilities ranks the Cayman Islands as the fourth largest international financial centre in the world; other well-known tax havens/OFCs include Switzerland (seventh), Netherlands (eighth), Ireland (ninth), Singapore (10th), Luxembourg (11th), Bahamas (15th) and Jersey (19th). These centres are recipients of approximately 30% of the world’s share of FDI and, in turn, are the originators of similar amounts of FDI (Palan et al. 2010).

There is some confusion between the concept of tax havens and OFCs. It is not only a matter of semantics. The different conceptions of the two terms go to the very heart of what is considered to be the problem (or not) with OFCs. Some experts see no difference between tax havens and OFCs, and employ the terms interchangeably. The term OFC or even IFC (international financial centre) is employed simply because it is less offensive than ‘tax haven’. Yet, historically, the two terms were distinct. Modern ‘tax havens’ are known to have existed at least since the beginning of the 20th century. ‘Offshore’ financial centres, in contrast, are a more recent phenomenon that became current only around the mid-1970s (Bryant 1983). They are broadly defined as markets in which financial operators are permitted to raise funds from non-residents and invest or lend the money to other non-residents free from most regulations and
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taxes. Most commonly, the designation ‘offshore’ financial market is used to describe the
wholesale international financial market, previously known as the Eurodollar market.

The contrasting views of the role of tax havens as OFCs derive to a degree from the different
understandings of the nature of the ‘offshore’ financial markets, i.e. the Euromarket. Some very
distinguished economists believe that the Euromarket is simply a wholesale financial market for
the US dollar that emerged in Europe in the 1950s (Schenk 1998). The term ‘offshore’ origi-
nally implied the location of the market outside the territorial boundaries of the USA. Over
time, the Euromarket came to denote any location of trades in non-resident ‘hard’ currencies
such as the British sterling, the yen, the Swiss franc, the Deutsche Mark and the euro. OFCs,
according to this thesis, are financial centres specializing in non-resident finance. However, in
this understanding the Euromarket is not distinct from any other market: as the majority, if not
all, of the world’s financial centres tend to handle both resident and non-resident currencies,
they all in fact, can be described as OFCs.

There is a very different theory that claims that the Euromarket is a very specific type of
market that emerged in late 1957 in London (Burn 2005). According to this theory, the Bank
of England came to an informal agreement with the City’s merchant banks to treat certain types
of financial transactions between non-resident parties and denominated in foreign currency as if
they did not take place in London, even though they occurred in London. Paradoxically, the
Bank created, in effect, a new regulatory space outside its jurisdiction, and a new concept—
‘offshore’ finance. But, as the transactions that took place in London were deemed by the Bank
of England to be taking place elsewhere, they ended up under no regulation at all, or ‘offshore’.
These transactions, according to this theory, take place in a new unregulated space called the
Euromarket, or the ‘offshore’ financial market (Burn 2005).

Experts who subscribe to this thesis sometimes call the Euromarket a booking device because
it has no existence outside the accounting books of banks and financial institutions. Such ‘off-
shore’ spaces are created when the books of foreign-to-foreign accounts are kept separate from
the books for domestic financial and capital transactions (or ‘on-shore’). The essential point is
that ‘offshore’ financial markets are unique, not because of the non-resident currencies that
are traded on their platforms, but because those exchanges escape nearly all forms of super-
vision, regulation and, often, taxation. This theory suggests that OFCs punched a hole at the
very core of the international regulatory map, a hole that must be addressed by current plans for
revisions of the international regulatory architecture.

As far as we can tell, the original rationale for the development of the Euromarket had little
to do with taxation. British banks developed the market as a way of coping with the new
regulation imposed by the British Treasury. The Euromarket remained small and practically
unknown for three or four years until US banks discovered it in the early 1960s. By the late
1950s, some of the US banks were among America’s and the world’s largest banks but, due to
US regulations, ‘even the largest of them individually possessed no more than about 3% of US
bank assets’ (Sylla 2002, 54). As a consequence, when US multinationals began to expand
international operations in the 1950s, US banks had difficulties servicing their needs. US banks
were caught in a funding squeeze. Once multinationals discovered the facility of the Euro-
market, they began to bypass US banks and tap directly into the Euromarket to earn higher
rates of interest, while the clients were also looking to the same Euromarket to fund their
operations (Burn 2005; Sylla 2002). Some of the leading US banks were savvy enough to
recognize the need to operate in the Euromarket. They rapidly developed branch networks in
London in the early 1960s with the intention of circumventing stringent US banking and
financial regulations. To stem the flow of capital to the Euromarket, the Kennedy Administra-


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preferential interest in the European markets. The results, predictably, were the opposite of what was intended. Instead of stemming the flow of capital out of the USA, American corporations kept capital abroad to avoid paying the interest equalization tax, fuelling in the process the growth of the Euromarkets. US banks soon learned that the unregulated environment in London allowed them (or their London branches) to circumvent all the New Deal regulations. They were able, therefore, to establish large diverse banks in London, capable of competing in every aspect of finance. German and Japanese banks then followed suit.

London emerged, therefore, as a ‘spontaneous’ ‘offshore’ financial market as a result of what might almost be seen to have been an administrative accident. All other areas under the jurisdiction of the UK at the time, including Hong Kong, the Channel Islands, the Cayman Islands and other British Caribbean islands enjoyed the same legal provisions and developed as spontaneous ‘offshore’ centres as a result. It did not take long, of course, for banks and other financial institutions to appreciate some useful synergies between tax havens and OFCs, particularly if located in the same place. In dual-status tax havens/OFCs, banks and other financial institutions could not only circumvent stringent financial regulations, but also find ‘tax efficient’ ways of conducting their business. This is why some tax havens developed as OFCs.

We also know from various reports that some of the smaller North American banks, US and Canadian, faced with the high infrastructural costs of a London base, ‘realized that the Caribbean OFCs offered a cheaper and equally attractive regulatory environment—free of exchange controls, reserve requirements and interest rate ceilings, and in the same time zone as New York’ (Hudson 1998, 541). According to various reports (Sylla 2002), the early spillover of OFCs’ activities into the Bahamas and Cayman was, like the London Euromarket, not motivated by tax advantages but because it was cheaper to set up branches in these locations. They had an additional advantage of sharing New York’s time zone. This explains why smaller US and Canadian banks were at the forefront of establishing Cayman’s OFC and why some experts use the shorthand description that the US and Canadian banks ‘established’ the Caribbean havens.

In 1981, due to the success of London’s ‘offshore’ centre, the US Treasury—which for years had unsuccessfully tried to fight off the fledgling ‘offshore’ financial market—reluctantly agreed to set up a more restrictive form of US ‘offshore’ market, the International Banking Facilities (IBFs). This type of facilities enabled depository institutions in the United States to offer deposit and loan services to foreign residents and institutions free of Federal Reserve System reserve requirements, as well as some state and local taxes on income. The Japanese Government created a similar structure in 1986 with the Japanese Offshore Market (JOM). Both the IBF and the JOM were modelled after the Singapore Asian Currency Market (ACU), which was set up in 1968. Bangkok also followed suit by setting up the Bangkok International Banking Facility (BIBF), Malaysia has somewhat similar arrangement in Labuan, as does Bahrain. According to some estimates, about one-third of international banking in the USA is undertaken in IBFs and nearly a half of Japanese banking is undertaken in the JOM. While the US IBFs and the Japanese JOM are exempt from some state and local taxes on income, they are not tax havens as such, but are, if anything, ‘regulatory havens’.

An important distinction to be made is among tax havens/OFCs themselves. There are, in fact, two important agglomerations of tax havens/OFCs. One of these agglomerations has a distinct British imperial flavour. It consists, first and foremost, of the City of London, and includes the British Crown dependencies of Jersey, Guernsey and the Isle of Man; British Overseas Territories including the Cayman Islands, Bermuda, British Virgin Islands, Turks and Caicos and Gibraltar; and recently independent British colonies such as Hong Kong, Singapore, Bahamas, Cyprus, Bahrain and Dubai.2 The British imperial pole accounted for a combined average of 38.3% of all outstanding international loans and deposits by March 2010 (BIS 2010).
Another important agglomeration consists of a string of mid-size European states known for their welfare provisions as well as for serving as tax havens. This agglomeration includes the Benelux countries, Belgium, the Netherlands and Luxembourg, as well as Ireland and Switzerland. This agglomeration accounted for a combined 14.9% of all outstanding international loans and deposits by March 2010, exactly the same as the USA. Combined, the two agglomerations accounted for approximately 53.3% of all international banking assets and liabilities by March 2010, down from 58.3% only a year before.

Shadow banking

The term 'shadow banking' is a relatively new addition to modern financial vocabulary. It is commonly attributed to Paul McCulley of PIMCO, who in his 2007 speech to the Federal Reserve Conference in Jackson Hole observed that the (then unfolding) financial crisis could be attributed to the growth of unregulated short-term funding, which may or may not be backstopped by liquidity lines from real banks. Because they fly below the radar of traditional bank regulation, these levered-up intermediaries operate in the shadows without backstopping from the Fed’s discount lending window or access to FDIC (Federal Deposit Insurance Corporation) deposit insurance. (McCulley 2009, 257)

The first comprehensive study of the US shadow banking system was published in late 2010 and quickly became a classic (Pozsar et al. 2010). The study mapped the structure of shadow banking in the US context, distinguishing between government-sponsored, internal and external shadow banking subsystems (Pozsar et al. 2010, 30–36). The study estimated that the size of SB activities in the USA was about US $6,000,000 million larger than the official banking system of the country. By 2010, these figures decreased, yet the significance of the shadow banking system for the US economy was still notable: it accommodated $16,000,000 million of assets. The Fed analysis prompted further efforts to identify, understand and map out the chains of the shadow banking system at the global level. In 2011, the FSB estimated that, globally, the shadow banking system’s assets totalled some €46,000,000 million in 2010, compared to €21,000,000 million in 2002. This means that shadow banking makes up an average of 25% to 30% of the total financial system and its size is equal to half of all bank assets (FSB 2011a). Recent calculations by the FSB put the size of the global shadow banking industry at $67,000,000 million. The so-called Anglo-Saxon financial system dominates SB practices, with the USA and UK accounting for 46% and 13% of the global shadow banking system, respectively; the shares of Japan and the Netherlands follow closely (8% each) (FSB 2011b). At the same time, analysts at all levels admit that, because so many of the practices of shadow banking remain obscure and take place under the regulators’ radar, current data on shadow banking activities may be underestimations.

Some commentators view the phenomenon of shadow banking as a paranormal development in the global economy, often linking it to tax evasion emanating from the underground, or unaccounted-for economy (Schneider et al. 2010; Buehn and Schneider 2010), and ultimately read derogatory connotations into the practices of shadow banking (Knutsen 2012). However, others highlight the very central role and key functions that shadow banking—risk, maturity and liquidity transformation—performs in today’s financial system. One key point of contention is the question of whether hedge funds—a largely unregulated part of global finance—should be identified as part of the SB system in the first place.
Shadow banking and ‘offshore’ finance

The emergent literature on mapping shadow banking structures also reflects the importance of historical and political economic institutions in its evolution. SB practices have historically been prominent in the USA, where funding of the economy is geared towards capital markets. Indeed, in the USA, a parallel financial system developed as early as the 1930s, despite the formal bifurcation between commercial and investment banking activities formalized by the Glass-Steagall Act (Kregel 2010). The City of London has also been accommodating specific financial innovations: securitization and resecuritization, over-the-counter (OTC) derivatives trade, collateral rehypothecation and repo market operations have thrived in the financial and legal space provided by the City of London. In the EU context, SB activities are associated primarily with universal banks. Reflecting the diversity of SB practices, the FSB defines SB as ‘credit intermediation occurring outside or partially outside the banking system, but involving maturity transformation and leverage, the defining characteristics of banking’ (Turner 2012).

Evaluations of the impact of the shadow banking system on the global economy vary. Most current studies view SB as an integral part of the global credit chain. Techniques and instruments of disintermediation and securitization, it is argued, help banking groups minimize costs, achieve efficiency gains and diversify their portfolios (Pozsar et al. 2010). Others argue that the obscurity of SB entities and practices add to uncertainty and lack of knowledge about the true financial state of many companies, contributing to the growth of ‘offshore’ financial havens and ‘secrecy spaces’.

Why has the phenomenon of SB emerged in recent times? Many current perspectives offer a functional perspective on these questions, diagnosing the phenomenon as an outcome of regulatory arbitrage in the financial system. Here, the Fed study notes that, while the interconnectedness of official and shadow banking structures is not problematic in itself, some elements of this linkage became sources of fragility because they reflected three specific types of arbitrage: (1) cross-border regulatory systems arbitrage, (2) regulatory, tax and economic capital arbitrage, and (3) ratings arbitrage (Pozsar et al. 2010). These arbitrage opportunities, in turn, arose out of the fractured nature of global financial regulation; the dependence of capital adequacy rules (Basel II) on credit ratings; and a series of uncoordinated decisions by accounting and regulatory bodies regarding the accounting and regulatory capital treatment of certain exposures and lending and asset management activities (Pozsar et al. 2010, 29–30).

Historical approaches to financial innovation suggest that shadow banking is more than a functional facet of modern finance. The search for new financial and legal space, and therefore financial innovation through off-balance sheet vehicles and operations, fulfils growing demand for funding otherwise unavailable within the constraints of the official (regulated) banking system. Here, several studies have analysed the increased role of repo markets in providing financing for companies (Adrian et al. 2011; Krishnamurthy et al. 2012), while other scholars and regulators have noted the acute problem of scarcity of high-quality collateral that is sought after by a multitude of institutional investors (Pozsar and Singh 2011; Moe 2012). While the debate about the legal and economic foundations of shadow banking is set to continue for quite some time, it is clear that the deep-seated origins of this phenomenon go beyond the regulatory domain of banking and pertain to the core questions about the balance between financial and ‘real’ economies, and to the way credit intermediation works in a capitalist system geared towards futurity (Palan 2013).

Regulatory efforts

Tax havens

The years 1998–2000 saw the beginning of a new phase in international efforts to combat tax havens. A co-ordinated, three-pronged attack was pursued by separate international organizations at a
multilayer level. The more significant developments in the battle against secrecy and tax havens were pursued, separately, by the EU and the USA. The OECD developed its campaign against harmful tax competition at the request of the G-7, the Financial Stability Forum (FSF)—precursor of the FSB—tackled financial stability, and the FATF money-laundering. There were already close links between the FATF and the OECD, not least because the FATF secretariat is located at OECD headquarters in Paris. An OECD report published in 2000 charted linkages between bank secrecy, money-laundering and tax evasion.

Initially, the most significant development in the battle against tax havens came in 1998 with the publication of a landmark OECD report entitled Harmful Tax Competition: An Emerging Global Issue (OECD 1998). We will focus our attention on the OECD’s efforts, which are still at the forefront of the multilateral efforts to tackle tax havens. Tax havens were described by the OECD rather forcefully as ‘free riders of general public goods created by the non-haven country’ (1998, 15) and ‘poachers’ (1998, 16). The OECD went so far as to invent a new ‘industrial sector’ to describe them, noting that ‘many havens have chosen to be heavily dependent on their tax industries’ (1998, 10)—‘tax industries’ being a creative term for ‘rent’.

The OECD is a think tank. It could do little more than build up peer pressure by ‘naming and shaming’, as it was called, states that practised harmful tax competition. The key to the OECD process was a promised list of non-co-operative jurisdictions, to be released by the end of 2001. Ominously, the 1998 report recommends that its members adopt serious defensive measures against non-co-operative countries. The OECD recognizes that Switzerland and Luxembourg are tax havens, but seems to be unwilling or unable to force them to change their policies.

The first OECD campaign proved a failure for a number of reasons. Primarily, due to conceptual difficulties in defining clearly harmful tax practices as opposed to the typical programme of complex tax rules, tax holidays and targeted subsidies practised by most advanced industrialized countries. Furthermore, some members of the OECD, such as Switzerland, Luxembourg, the Netherlands, the USA and the UK, are also considered tax havens. The OECD had no recommendations on how to deal with those. For all these reasons the OECD campaign against harmful tax competition was whittled down by 2004 (Sherman 2006). Despite the weakening of the OECD’s original initiative, the OECD recognized its campaign as a complete success, declaring that all states were removed from its black list, and moved on quietly to the next set of programmes.

The failure of the concept of harmful tax competition convinced the OECD that a different angle was needed. There was a simple and obvious argument to be made. If tax havens were not different from any other countries, and if they were regulated and responsible members of the international community as they have argued, why then is there a need for secrecy? Legitimate business should be able to stand to scrutiny. The OECD shifted its attention, therefore, to what Richard Murphy described as ‘secrecy locations’, seeking to break down the walls of secrecy and opacity that were constructed by tax havens.

There is a debate as to how to go about it. Many have argued that only a system of automatic exchange of information among countries can resolve the abuse perpetrated by tax havens. In such systems, countries will routinely pass on information on foreign holders of banking accounts, companies, trusts, etc. to their respective countries of origin. As to be expected, automatic exchange agreements are resisted by the finance industry. Instead, a compromise position was reached, where bilateral tax informational exchange agreements (TIEA) would be entered into among countries. TIEAs are rather cumbersome agreements signed between countries for exchange of information in case of reasoned suspicion of possible financial abuse. In support of the TIEA system, the OECD has launched, in conjunction with the
Global Forum, an ambitious project of peer review process, by which all countries in the world are subject to peer review by delegates from other countries with the aim of strengthening the principles of know your client and techniques of information exchange.

The EU instituted another system of limited automatic exchange. Since July 2005, all EU member states, as well as Switzerland and EU dependencies, are required to exchange information with the relevant national authorities. Austria, Belgium and Luxembourg retained their bank secrecy rules, but are required to impose a withholding tax on earnings from deposits starting at a rate of 15% from 2005 to 2007, rising to 20% from 2008 to 2010, and to 35% thereafter. The two systems combined, argues Itai Grinberg,

share one thing in common: they require financial institutions to be cross-border tax intermediaries … these two forms of cross-border administrative assistance represent an important shift for the international tax system. For years, financial institutions have acted as domestic tax intermediaries by providing information reporting on their domestic payees to the tax administration of their country of residence or withholding from such payees. (2012, 4)

The new system put the burden on financial institutions as cross-border intermediaries between respective tax authorities.

At time of writing, three models of tax information agreement are emerging: (1) the OECD’s authorized intermediary project, (2) the EU’s Directive on Administrative Cooperation in the Field of Taxation and proposed revision of the EU Savings Directive (EUSD), and (3) the United States’ Foreign Account Tax Compliance Act (FATCA) legislation. There are differences among them, but Grinberg again is correct when he writes about the communality among the three. They each require ‘domestic financial institutions to routinely provide cross-border administrative assistance to a sovereign outside the country in which the financial institution is located, and thereby serve as cross-border tax intermediaries’ (Grinberg 2012, 16). We are moving, in other words, in the direction of automatic exchange agreements, where the onus of collecting, storing and retrieving information is placed on the financial actors themselves.

**Regulating shadow banking**

As the previous sections suggest, our understanding of the phenomenon of shadow banking is in its infancy. And, although the very functioning of the many types of shadow banking entities is inevitably linked to the existence of tax havens and financial secrecy spaces, comparatively little effort has been dedicated to the question of how the shadow financial system can be regulated, as opposed to the much longer running debate on the regulation of tax havens. The lack of available expertise partly reflects the relative novelty of the problem: although non-bank financial intermediation has always existed in most economic systems, the destabilizing impact of financial innovation through SB was recognized only a few years ago, in light of the 2007–09 crisis.

In the emergent regulatory literature on shadow banking it is possible to delineate two levels of regulatory focus. On the one hand, the broad umbrella of post-crisis transatlantic financial reforms includes ongoing efforts to identify, isolate, monitor and control the risks associated with entities that inhabit the complex world of shadow banking. For example, Deloitte (2012) has identified several segments of financial activities typically linked to shadow banking that will be affected by post-crisis regulatory reforms. These include money market mutual funds, asset-backed commercial paper conduits, private-label securitization, and repos and securities lending.
Many reform initiatives emanating from the post-crisis regulatory moves (such as Basle II/III, the Dodd-Frank Act or the Volcker or Vickers rules) are aimed at enhancing market discipline associated with the use of these entities and increasing transparency and prudential regulation of activities linked to these entities and processes.

While some isolated destabilizing practices that led to the crisis of 2007–09 would be tamed under such an approach, the ultimate effect of these moves remains unknown. Singh (2012) for instance, has argued that the effort to shift OTC derivatives trade from the banks’ books onto organized clearing houses will simply create a new ‘too-big-to-fail’ problem in global finance. In a new, ‘cleared’ world of derivatives trade, risk will simply be shifted from individual banks to new institutions similar to concentrated ‘risk nodes’ in the financial system, while existing regulatory apparatus is not adept at dealing with resolution of such systemic risk nodes in times of stress or crisis. Generally, it is fair to say that this line of regulatory focus on the problem of shadow banking is underpinned by the ultimately benign view of financial innovation generally. Indeed, the problem that needs to be targeted, according to these proposals, is not financial instability or financial innovation per se, but the workings of the individual parts of the financial system that have malfunctioned in the preceding economic cycle.

At another level, a more serious academic and policy debate about the linkages between SB units and structures, and the channels of the official banking system has only just begun (Amato and Fantacci 2012; Mehrling 2010; Lysandrou 2012; Bakk-Simon et al. 2012). In contrast to the targeted approach of post-crisis regulatory reform outlined above, this level of discussion is founded on the concerns about the ultimate function of financial innovation by private market participants in context of a business cycle (Borio 2012), and thus is ultimately linked to the question of the imbalance of gains and losses between the private and public sector in financial capitalism. Adair Turner (2012) has summarized this discussion as being framed around three key questions: (1) how much financial innovation is actually useful; (2) whether to regulate or isolate shadow banking from the rest of the financial system; and (3) how to manage pro-cyclicality of secured finance.

According to Turner, major post-2009 regulatory moves, such as the Basel III Accord or national banking laws and securities legislation, will help enhance regulation of these areas, while the ongoing work at the global financial bodies such as the FSB should help to ascertain whether specific regulatory focus on shadow banking is needed in the effort to reduce instability associated or driven by financial innovation. However, three major factors stand in the way of addressing this set of questions. First, the answers are inevitably interlinked and require a formidable concentration of technical expertise and up-to-date knowledge of financial practice, legal rules and political realities. It is unclear whether such concentration of knowledge exists at the level of international regulatory bodies; indeed, even in the framework of the BIS—probably the best-equipped organization of global financial governance—post-crisis regulatory initiatives have been progressing slower than originally planned.

Second, the core challenge in any comprehensive governance plan is to understand financial innovation and its connectivity with the elements of the economic system, a task which is not helped by the current state of mainstream economics and the continuing crisis in the eurozone. Third, any type of radical financial reform tends to be seen by the financial community as constraining the field of profit-making, thus igniting political sensitivities around any regulatory agenda. At the same time, in 2012 Adair Turner noted that

> given the enormous cost which instability can produce, and given the uncertain benefits which this complexity has delivered, our regulatory response should therefore entail a bias to prudence—a bias against complex interconnectivity, against procyclical market contracts,
and against allowing maturity transformation or high leverage to develop in unregulated institutions or markets.

\[\text{Turner 2012, 36}\]

The viability of such a prudent, and radical, approach to financial governance ultimately relates to a more general issue about the underlying paradigm of economic regulation and governance. The priorities set out by ambitious regulatory proposals can only be addressed if the elements of the economic and financial cycle, as well as their interconnectivity in the contemporary economic context, are understood well. Most current approaches to macroeconomic and financial modelling have been built without the notions of a financial cycle: the issue of connectivity has fallen out of fashion in mainstream economics, and was the subject of research of only a few economists outside the mainstream. Yet, as Borio argues, in reality, and in contrast to most existing models of economic equilibrium, the financial cycle is much longer than the traditional business cycle. The financial system today does not just allocate, but also generates, purchasing power. And in the global context, the dynamics of different financial cycles are highly integrated (Borio 2012, 2–3). In this framework, any policy towards regulation of shadow banking needs to centre on the question of the relationship between private and public debt and debt management. As Borio continues, this recognition in turn, suggests that an effective management of post-crisis stagnation or depression should centre on the idea of substituting public sector debt for private sector debt. This is based on the public sector’s superior ability to bring forward (real) resources from the future, underpinned by its power to tax (e.g. Holmström and Tirole 2011).

However, the greatest hurdle towards a world of more accountable financial innovation is that, despite the change in tone, the regulatory efforts of financial architects are constrained by the political environment of yesteryear. This is represented most vividly by the political regimes in the UK and Germany, but also by national economic policies that continue to be built on the benign view of financial innovation (and by association, private financial leverage that had been magnified through shadow banking), and an a priori negative understanding of the role of public debt in the economy. Unless this dogmatic view is reversed, the practices of shadow banking, and the financial fragility driven by them, will continue to thrive in the economy that is otherwise stricken by a protracted recession.

\section*{Conclusion}

The crisis of 2007–09 and its aftershocks have revealed a series of structural, institutional and functional problems caused by financial innovation. Many of the problems pertain to the notion of systemic risk in finance today and the way in which the costs of financial crises are externalized from the private sphere of the financial markets to the public realm of the economy and society. The crisis in particular has cast light on two important, yet until recently hidden, dimensions of the contemporary financial system: the global economy of tax havens and ‘offshore’ finance, and the complex web of entities and practices that has been dubbed ‘the shadow banking system’.

The governance of these black holes of the global economy constitutes one of the most difficult challenges confronting regulators and policymakers. In this chapter, we have reviewed some of the key initiatives currently being discussed at national and global levels of financial policymaking. The ‘black holes’ of the contemporary financial system do not only pose intellectual and practical challenges to policymakers and regulators, but also to academics analysing the nature of the global economy. In an environment where many scholars are habituated to
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think in a particular way about the world we inhabit, we find the evolution of such alternative, often virtual spaces, disconcerting.

Our analysis suggests that any regulatory move aiming towards a more effective regulation of ‘offshore’ finance and shadow banking requires a formidable degree of expertise about the operation and functions of these financial realms. In our opinion, a number of research departments at the Federal Reserve, the Bank of England, the BIS and the ECB but, interestingly, less so at the IMF and the World Bank, emerged as leaders in both gathering information and producing innovative, out-of-the-box thinking about the current dilemmas. Still, perhaps due to institutional biases, in most popular accounts, the two phenomena are treated as somewhat marginal to the core processes of economic globalization, crisis management and economic regulation. Despite the staggering data associated with the amount of capital accommodated in ‘offshore’ finance and shadow banking structures, current debates in economics and political science reflect this vision.

One of the most crucial steps towards a better regulation of these financial black holes lies in finding an alternative analytical framework that would allow us to understand the real linkages between, and within, the economy, financial system and its shadow components. Economic orthodoxy, as this chapter has suggested, is unable to offer such vision. There are very few signs of any comprehensive attempt to deal with the complexities of financial regulation in the age of financial innovation. At the time of writing, it is also not entirely clear whether OFCs and shadow banking will be part of the new regulatory architecture. If they are not, then the emerging system of global financial regulation is doomed to fail.

Notes

1 With a few notable exceptions, such as financier George Soros.
2 Bermuda, which is the largest captive insurance centre in the world, but has a relatively small banking centre, can be included as well, as, indeed, the more numerous but less significant former British colonies in the Pacific. For discussion of Bermuda’s financial centre, see Cronbie 2008. For discussion of the Pacific ‘offshore’ centres and their relationship to the UK see Sharman and Mistry 2008.
3 Of the 11 best known and most authoritative lists of tax havens, Switzerland is considered a tax haven by nine of them, Luxembourg and Ireland by eight, the Netherlands by two and Belgium by one (Palan et al. 2010). Switzerland and Liechtenstein share a customs union as well as strong political links. Observers tend to treat the two countries as a linked financial centre (Kuentzler 2007).
4 The USA, in contrast, accounted for 12.4% and 12.9% of all outstanding international loans and deposits, and Japan for 4.5% and 3.8%, respectively in March 2009, while the European havens were about 2% higher only a year before. The USA appears to have been the only large net gainer during the crisis of 2007 and since.
5 Similar to the ‘internal’ shadow banking subsystem (which evolved historically in parallel to the moves away from deposit-based banking to the ‘originate and distribute’ model of banking), the ‘external’ shadow banking subsystem was a global network of balance sheets, with the origination, warehousing and securitization of loans conducted mainly from the USA, and the funding and maturity transformation of structured credit assets conducted mainly from the UK, Europe and various ‘offshore’ financial centres. However, unlike the ‘internal’ subsystem, the ‘external’ subsystem was less of a product of regulatory arbitrage and more a product of vertical integration and gains from specialization (Pozsar et al. 2010, 36).
6 The Netherlands has a large and sprawling OFC.
7 Credit transformation refers to the enhancement of the credit quality of debt issued by the intermediary through the use of priority of claims. For example, the credit quality of senior deposits is better than the credit quality of the underlying loan portfolio due to the presence of junior equity. Maturity transformation refers to the use of short-term deposits to fund long-term loans, which creates liquidity for the saver but exposes the intermediary to rollover and duration risks. Liquidity transformation refers to the use of liquid instruments to fund illiquid assets. For example, a pool of illiquid
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whole loans might trade at a lower price than a liquid rated security secured by the same loan pool, as
certification by a credible rating agency would reduce information asymmetries between borrowers
and savers (Pozsar et al. 2010, 8).

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The eurozone crisis
Growing pains or doomed from the start?

Matthias Matthijs

The euro house, for all its rickety defects, has proved durable through three years of stormy weather, relying on one shoddy compromise after another. The house may sag in places, the floorboards may be warped, and the roof may leak. But for all that, there is no reason to believe that it cannot long remain habitable, albeit uncomfortable. Europe’s leaders will not let it fail. Europe’s politics will not let it succeed. The euro, defective but defended, will simply endure.

Benjamin J. Cohen (2012, 699)

Introduction: From global financial crisis to European sovereign debt crisis

The creation of the euro at Maastricht in December 1991 was intended to be the next step towards post-Berlin Wall political unity: through economic convergence, Europe would become a more politically integrated region. Instead, policy efforts that were theorized to lead toward economic convergence actually resulted in economic divergence. In an ironic twist, this divergence has reawakened old political divisions on the European continent—the very problem that the euro was introduced to put to rest once and for all.

Catalysts of the euro crisis

The sovereign debt crisis that continues to shake the eurozone and took the Brussels-based policy elite by surprise in the spring of 2010 was in many ways the logical consequence of the global financial crisis. The underlying causes of that crisis have by now been widely debated and analysed by academics, journalists and policymakers alike, but no single dominant narrative, able to reconcile those multiple but often contradictory accounts, seems to have emerged (Lo 2012). That being said, most observers would probably agree that the crisis had its roots in the bursting of the mortgage debt bubble caused by the collapse of the US housing market in 2007. Once it became clear how a ‘global inverted pyramid’ of debt was actually built on a very thin base of dilapidated American sub-prime mortgages, the ‘debt balloon started to deflate, at first slowly, [but] ultimately with devastating speed’ (Skidelsky 2009, 4). Banks soon stopped lending
altogether—both to each other and to their private customers—which caused a ‘credit crunch’ in the beginning of 2008, putting an enormous deal of pressure on the American and global financial system.

The investment bank Bear Stearns was the first major victim of the crisis. On the brink of failure in March 2008, it was rescued at the 11th hour by JP Morgan Chase, which was persuaded by US authorities to buy the bank only after firm guarantees of direct government support for the takeover. By the summer of 2008 commodity prices had started to fall and the two giant American mortgage lenders, Fannie Mae and Freddie Mac, were formally taken into public ownership (Skidelsky 2009, 4–5). These incidents were part of the run up to the astonishing events of September 2008, when the world economy was at the edge of an abyss and flirted with complete meltdown: Lehman Brothers was forced to file for bankruptcy, Merrill Lynch narrowly avoided Lehman’s fate by absorbing into Bank of America, and large banks all over the world had to be rescued by their governments. Furthermore, despite the injection of record amounts of liquidity into economies by central banks world-wide, stock markets plunged. The prevailing uncertainty led to a massive slide of the real economy, resulting in falling output levels, rapidly increasing unemployment, weakening consumption and rising savings: a classic case of a Keynesian liquidity trap (Matthijs 2010, 190).

As the world’s major capitals were haunted by the spectre of a new Great Depression, only one thing seemed certain in the midst of the prevailing financial market chaos: governments had to step in to rescue their banking systems and guarantee most of their banks’ deposits if they were to avoid a repeat of the 1930s. Central banks quickly slashed interest rates to close to zero, and governments’ budgetary authorities—in haste—put together fiscal stimulus packages of a magnitude unparalleled in peacetime. Nevertheless, these efforts would not be enough to avoid the world economy’s first output contraction since World War II, shrinking by 0.6% in 2009. The advanced economies contracted by 3.5% on an annual basis, while emerging and developing economies barely grew, recording a meagre 2.7% average growth rate that year (IMF 2013, 149). While the world economy did steer clear of another Great Depression, it was definitely dealing with a ‘Great Recession’, and a fierce debate over what had caused the series of events leading up to the economic calamity quickly entered into full swing (Lo 2012).

The initial focus of the financial crisis—during the autumn of 2008 and spring of 2009—was on those countries with heavily developed and exposed financial sectors, like the USA, the UK and Iceland. Around that time one could detect some not so thinly veiled schadenfreude in the capitals of Continental Europe, with economic and political elites in Paris and Berlin revelling in the superiority of their ‘Rhineland’ model of social market capitalism. In the minds of German Finance Minister Peer Steinbrück and French President Nicolas Sarkozy, to name just two examples, the crisis was laying bare all the structural shortcomings of the Anglo-Saxon model of ‘financialized’ capitalism preached by Washington and London since the early 1980s. In Britain, there was even brief talk among academics, Liberal Democrats and pro-European Labour politicians of the ‘missed opportunity’ of not having joined Europe’s Economic and Monetary Union (EMU) in the late 1990s (Buiter 2008, 269). During a ceremony at the European Parliament in January 2009 to mark the 10-year anniversary of the single currency, the overall atmosphere was one of ‘euro-phoria’ and self-congratulation (Trichet 2009).

However, the continental hubris would be short lived. The financial crisis quickly spread from the USA and the UK to Continental Europe (and also to the rest of the developed and developing world). In order to stem wholesale financial collapse, all advanced industrial states of the eurozone—especially Germany and Ireland, who had allowed their banks to invest heavily in the American mortgage market—authorized large bailouts of their financial sectors and passed fiscal stimulus plans to support their economies (Scharpf 2011, 21). By mid-2009 it was clear

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that many governments in the eurozone—with the Southern European countries along the Mediterranean (Greece, Italy, Portugal, Spain) and Ireland (all five together soon dubbed the ‘PIIGS’ by financial markets) in the vanguard—were facing the consequences of a triple fiscal blow: a collapse in government revenue due to the recession, a fast increase in spending due to rising unemployment and large stimulus bills, and the extra cost of adding the toxic private debt onto public sector balance sheets. Together, these three blows translated into ballooning budget deficits and sovereign debt. The eurozone suddenly went from a zone of stability to the centre of the financial storm.

As Reinhart and Rogoff explained, we should not be surprised that financial crises often lead to fiscal and sovereign debt crises (Reinhart and Rogoff 2009). And to paraphrase the title of their book, this time was no different. Governments, after having bailed out their financial sectors with an unmatched infusion of public money, suddenly found themselves owning all that bad debt. As the focus of financial market participants gradually shifted from private debt in 2008–09 to sovereign debt in late 2009 and early 2010—triggered by Europe’s initial hesitation on what to do about Greece’s pending sovereign debt default—concerns about the long-term fiscal solvency of Europe’s periphery led to the evaporation of confidence in ‘PIIGS’ bonds and the subsequent flight of capital to safety. Bond traders sold risky Mediterranean sovereign debt and purchased perceived risk-free assets such as German bunds and American T-bills, which only served to worsen the debt situation, forcing Greece to the brink of an actual default. This uncertain situation led to a highly fluctuating euro-dollar exchange rate and rapidly widening sovereign debt yield spreads within the eurozone during the spring of 2010. As The Economist put it at the time, now it was the rescuers who needed rescuing (The Economist 2010).

The euro crisis holds valuable lessons for the global governance of finance and money. It taught us about the collective action problem with 17 national players, the intrinsic difficulty of dealing with international capital flows that are regulated mainly nationally, the tension between democratic national legitimacy and the power of supranational institutions, the dangers of an incomplete monetary union, the relevance of competing economic paradigms in solving crises and the fact that monetary policy is not just a purely technical matter. This chapter proceeds in five main sections. The next section analyses the multiple narratives informing Europe’s response to its sovereign debt woes. Central to understanding the various ad hoc solutions cobbled together by the various European players is recognizing which explanations of the causes of the crisis eventually won out or proved more influential. The following section gives a brief overview of the main decisions that were taken during the multiple summits that took place over three years between late 2009 and late 2012, while the section after that analyses those decisions from interest-based (players), institutional (power) and ideational (paradigmatic) points of view. The penultimate section looks at the future of the eurozone, assesses the viability of a more permanent solution and outlines the main lessons of the euro crisis for the global governance of finance and money. The final section concludes.

Causes of the euro crisis: multiple explanations and competing narratives

A crisis is usually typified by high levels of uncertainty and multiple, competing explanations about its main causes (Blyth 2002). How the various crisis narratives play out politically is crucial to understanding the eventual policy response, and whether the reforms will be incremental or more radical in nature (Matthijs 2010, 2). This section will give the reader a sense of the eurozone debate by surveying seven of the different, and often overlapping, explanations of what went wrong with the euro. Naturally, those differing explanations also offer very different solutions to the crisis.
For most American economists, the euro crisis was a ‘crisis of design’ because Europe does not fulfil most of the conditions that would qualify it to be an optimum currency area. Northern European public opinion generally holds that this was a budgetary crisis of excessive spending and deficient tax collection, noting especially the high fiscal deficits and debt-to-gross domestic product (GDP) ratios in Southern Europe. For German industrialists, this was a crisis of competitiveness; labour costs in the PIGS economies rose too fast in the previous decade compared to the North. For many academic observers, the euro crisis was a crisis of intra-EMU macroeconomic imbalances due to integrated European capital markets lacking a common debt instrument, and too high savings in the North offsetting too low savings in the South (Wolf 2010). For many politicians and pundits on the left, it was a crisis of ‘efficient’ financial markets, while for European Union (EU) scholars it was a crisis of European institutions. Finally, some blamed European policymakers themselves for making the crisis worse by ‘spooking the markets’ every time they made conflicting statements during the numerous crisis summits held in Brussels (Jones 2011). I will now examine those competing crisis narratives one by one.

The first explanation of the euro crisis is put forward by many American economists and is best captured by Martin Feldstein who has argued that this was a crisis of institutional design (Feldstein 2012). According to this view, the Economic and Monetary Union of the original 12 member states that physically introduced the euro in 2002 was not an optimum currency area (OCA) (Mundell 1961). Therefore, the project, though it could well work for a long time under favourable economic conditions, would eventually end in crisis the moment conditions became unfavourable. No monetary union, as the OCA argument went, could ever survive without a serious fiscal transfer mechanism, which would be needed in the case of asymmetric shocks. Furthermore, there was insufficient business cycle convergence and too little labour mobility in Europe, while product and labour markets remained relatively rigid in Southern Europe compared to Northern Europe at the time the common currency came into effect. In order to counter the unpalatable directives of OCA theory, the European Commission and European Central Bank (ECB) put forward the theory of ‘OCA endogeneity’, arguing that the introduction of a monetary union would increase trade and financial integration by a steep decline in transaction costs and the elimination of all exchange rate risk (Mongelli 2002; Matthes 2009). Thus, increased trade and financial integration would lead to greater business cycle convergence, and therefore a greater fitness of the participating countries to join a currency union. The benefits would soon outweigh the costs. Most economists countered that the endogeneity thesis was too optimistic. As early as the 1990s, Feldstein had argued that it confused European dreams with reality (Feldstein, 1997).

The second explanation, popular in much of Northern Europe, is that this was simply a budgetary or fiscal crisis. From this point of view, the Stability and Growth Pact (SGP), which had built on the Maastricht ‘convergence criteria’ that had to be met in order for a country to join EMU, was far from ‘stupid’, as former Commission President Romano Prodi once called it, but rather a good idea that was never actually implemented. Had it been, budgetary and fiscal excesses would not have been tolerated and they would have been nipped in the bud early on. This ‘good idea’ was undercut by the European Council, in trampling the European Commission’s power over a looming ‘excessive deficit procedure’ for France and Germany in 2003. Ignoring the SGP then, as the Council did in 2003, opened up Pandora’s proverbial box, and set a dangerous precedent for smaller, peripheral countries who drew the conclusion that their fiscal profligacy would go unpunished in the future. The result was widening public sector borrowing, and increased public spending, facilitated by an accommodating financial environment (low interest rates) which made borrowing cheap and ostensibly low risk. Southern European countries especially took advantage of the historically low interest rates—courtesy of
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Germany’s credibility—to go on a public spending spree. Once the financial sector collapsed and needed a bailout in 2008, many governments, which were already deeply overleveraged, had to go deeper into debt to save their financial systems from collapse. This view—which is not borne out by the facts, and to some extent only applies to Greece—corresponded to the German nightmare scenario of the early 1990s. The German fear at the time was that other EMU members would free ride on German credibility and be able to borrow cheaply, hence undermining the credibility of the eurozone as a whole.

The third crisis narrative, common among German business elites, is that this is a crisis of competitiveness in Southern Europe. North-South divisions widened after the euro launch in 1999 because labour costs in the Mediterranean rapidly increased and total factor productivity divergences quickly priced their goods and services out of the Northern European market. As the economies of Southern Europe and Ireland were booming in the early 2000s, wages tended to go up faster in those countries compared with their trade partners, especially Germany, which saw slightly negative wage growth from 2000 to 2007. The persistence of growth and inflation differentials therefore led to significant trade imbalances within the euro area, with Germany seeing record trade surpluses and the PIIGS suffering ever larger external deficits. In this view, Germany is more competitive than the rest of Europe because of the painful reforms enacted under the Schröder Governments in the early 2000s, which meant that German unions accepted wage restraint, allowing growth in productivity to outpace the increase in labour costs (Scharpf 2011, 13–15). As this reasoning went, the introduction of the euro in 1999 took away all incentives in Southern Europe to continue the structural reforms that it had started in the 1990s.

Financial Times columnist Martin Wolf most forcefully argued for the fourth explanation, which is to some extent the flip side of the previous crisis narrative. According to this view, the euro crisis happened because of unsustainably large intra-European macroeconomic imbalances. Initial bond spreads in the 1990s allowed market participants, especially pension fund managers, to buy higher yield (and triple-A rated) Mediterranean bonds and sell their lower yield Northern European bonds. This flooded Southern European countries with capital, fuelling a cycle of housing booms and consumer spending, causing their current accounts (and goods markets) to adjust. The evidence for this view seems considerable (Blyth and Matthijs 2012): while Germany’s trade surplus with the rest of the EU was €46,400m. in 2000, it had grown to €126,500m. in 2007. Looking more closely at the evolution of Germany’s bilateral trade surpluses with the Mediterranean countries between 2000 and 2007, Greece’s annual deficit with Germany grew from €3,000m. to €5,500m., Spain’s almost tripled from €11,000m. to €27,200m., Italy’s doubled from €9,600m. to €19,600m., and Portugal’s quadrupled from €1,000m. to €4,200m. (Eurostat 2010, 145). Similarly, an IMF (International Monetary Fund) working paper revealed Germany and France to be the two biggest net creditors within the eurozone in 2008 with intrazonal net investment positions of +€735,000m. and +€764,000m., respectively, the exact mirror image of Portugal (–€136,000m.), Greece (–€199,000m.), Italy (–€334,000m.) and Spain (–€794,000m.) (Waysand et al. 2010; Matthijs and Blyth 2011). According to this view, it was the capital flows from North to South in the late 1990s and early 2000s that caused the current account divergences across Europe. Capital markets cleared first, goods markets followed later (Jones 2010b, 14).

The fifth narrative, often ignored in much of the academic literature, but mainstream among social democratic politicians in Europe, is that this was a failure of efficient financial markets. Interest rate convergence between Northern and Southern Europe should not have happened according to this view, since it was based on a fundamental mispricing of risk in the sovereign debt holdings of different European countries. The idea that Greece and Germany could
borrow at almost the exact same interest rates over 10 years was based on financial market participants ignoring the ‘no-bailout’ clause in the Maastricht Treaty. This narrative also singles out the international ratings agencies, such as Moody’s, Standard and Poor’s and Fitch, for failing to lower the triple-A rating of the PIIGS countries much earlier on, which would have tempered the excessive public and private borrowing during the 2003–07 boom. In a way, the higher yields for certain EMU countries starting in 2010 signified a return to ‘normal’ interest rate pricing, in which policies deemed deficient are instantly punished with default premiums by financial markets. Also, this narrative emphasizes Hyman Minsky’s observation that financial markets tend to underprice risk during economic booms and overprice risk during recessions (Minsky 1986). In other words, markets tend to discipline governments excessively during downturns by charging too high interest rates and do not rein in spending sufficiently during economic upswings by setting interest rates that are too low.

The sixth euro crisis explanation has many scholars of European integration look at Europe’s sovereign debt crisis as a crisis of European institutions (Schmidt 2012). The problem at the heart of European institutions is that of ‘divided sovereignty’ and the lack of a true ‘economic government’ for the eurozone (Jabko 2011). Since the eurozone’s monetary policy is conducted exclusively at the European level by the ECB in Frankfurt, while most other policies—including banking supervision, deposit insurance and fiscal policy—are set at the national level, there was bound to be an eventual clash over economic policy. Moreover, since the eurozone has no common debt instrument (a ‘Eurobond’), there is no European safe asset that all members are able to issue. This means that, during a financial panic, capital will flow out of the weaker member states into the stronger member states, rather than from one asset class to another. This European institutional narrative views deeper economic integration as a necessary step to solve the crisis once and for all. However, at the same time, these scholars are aware that there is very little political desire for a ‘transfer union’ and domestic politicians in most member states are loth to give up more of their sovereignty to Brussels (Jabko 2011). The fact that decision-making at the European level happens by consensus makes the crisis response often too slow to reassure fast moving international financial markets, which has a tendency to deepen the eurozone’s problems.

The seventh and last crisis narrative blames the euro crisis on bad information and a series of missteps by European policymakers during the crisis. Conflicting statements about the no-bailout clause, the size of the European Financial Stability Facility (EFSF), IMF involvement, conditionality, whether weaker eurozone members should be allowed to leave or be kicked out, and so on, ‘spooked’ the markets, artificially worsening the crisis (Jones 2012b, 146–51). This last view is complementary to the previous view, namely that more effective institutions at the EU level, together with more transparent tools for information and communication, a more cohesive decision-making process, and a broader mandate for the ECB could have stopped the crisis from turning a lot worse in 2010. Furthermore, the continued dithering and indecisiveness on the part of EU policymakers, as well as national leaders—especially German Chancellor Angela Merkel—added to the anxiety and panic in the markets. A much more decisive and rapid response in early 2010, a financial ‘bazooka’ similar to the way the US Treasury and Federal Reserve responded to the US meltdown in September 2008, could have reassured financial markets early on and averted the worst of the euro crisis in 2011 and 2012.

Three years of EU summits and EU solutions: an overview

It is fair to say that all seven crisis narratives discussed above informed the debate and search for solutions at some point during the eurozone crisis, but it was clear from early on that some
narratives, especially the second (fiscal) and third (competitiveness), were more influential than others. Why exactly that was the case is analysed in the next section, applying the Handbook’s main theoretical framework of the three Ps—players, power and paradigms. But, first, we need to understand how exactly the euro crisis unfolded, from a Greek fiscal drama to a full-fledged European sovereign debt crisis: a crisis that would call into question the very existence of the euro and the future viability of Europe’s bold monetary experiment.

After a snap election called by Prime Minister Costas Karamanlis of the New Democracy Party (NDP) in October 2009, Greeks, frustrated by a weak economy, voted for change and George Papandreou and his Pan-Hellenic Socialist Movement (PASOK) swept to power. The new Government would soon uncover that the country’s public finances were in a much worse state than previously believed, and blamed faulty accounting practices for concealing excessive borrowing during the NDP administration. In November 2009, Papandreou announced Greece’s budget deficit at 12.7% of GDP for the year, twice as high as previously estimated. Markets initially remained calm, with Greek–German bond spreads barely moving, as the risk of a higher-than-expected deficit was already priced in. After sovereign downgrades by all three main rating agencies at the beginning of 2010 and a deteriorating stock market, and with total Greek debt now estimated at 113% of GDP, Papandreou unveiled a draconian austerity plan in February 2010 aimed at reducing the deficit by close to 10% of GDP in just two years. The plan included various tax increases and a freeze on public sector wages. However, as riots and wildcat strikes crept up all over Greece, and the deficit for 2009 was further revised upward to 13.6% of GDP, it became clear that the country could not cut its way out of its crisis and would need outside help. Due to initial dithering at the EU level, the rating agencies downgraded Greek sovereign debt to junk status in April 2010, and financial market panic now started to spread to the rest of the eurozone periphery, resulting in widening bond yield spreads between Germany and the PIIGS countries and a tumbling euro vis-à-vis the dollar (Jones 2010a, 25–30).

After weeks and months of uncertainty at the EU level, filled with fragmented and uncoordinated meetings between the main European players, including German Chancellor Angela Merkel and French President Nicolas Sarkozy, the Greek crisis was countered with a €110,000m. bailout package put together jointly by the EU and the IMF in early May 2010. The bailout was conditional on a whole series of new austerity measures, including tax hikes and expenditure cuts. The markets did not think this sufficient, as the problem now had moved beyond Greece to Ireland and Portugal, with the sights of the financial markets increasingly fixated on Spain and Italy—all economies with high deficits and rising debt levels. Just one week after the Greek bailout was announced, the EU member states and the IMF responded by putting together a rescue package of €750,000m. for the currency bloc. The rescue plan consisted of €440,000m. eurozone-backed loan guarantees for crisis-stricken members raised by a newly created (and triple A-rated) European Financial Stability Facility (EFSF); a European Union balance of payment facility totalling €60,000m. to raise debt by the European Commission using the EU budget as collateral; and €250,000m. in loans from the IMF. Furthermore, the ECB promised to intervene in secondary public and private debt markets, and take extra measures to boost eurozone bank liquidity. However, rather than putting the crisis to rest, all this did was buy a couple of months’ time.

After a relatively quiet summer for the eurozone, Ireland’s central bank announced in September 2010 that the cost of bailing out Anglo Irish Bank, which had been taken into public ownership by the Irish Government in January 2009, was a lot higher than expected, bringing the Irish budget deficit for 2010 to an astronomical 31.2% of GDP (Eurostat 2012). After a bilateral meeting between Angela Merkel and Nicolas Sarkozy in Deauville in France, where
they agreed on the need for private sector involvement (PSI) to solve Greece’s debt hangover, the Irish crisis intensified, making an Irish bailout all but inevitable (BIS 2010). During the European Council meeting a couple of days later in Brussels in late October 2010, the EU heads of state agreed to amend the Lisbon Treaty in three significant ways. First, the EU would create a new macroeconomic surveillance network to detect emerging imbalances and risks, including divergences in competitiveness. Second, EU leaders agreed to strengthen national governments’ fiscal responsibility under a revised and much stricter Stability and Growth Pact. In the future, progressive sanctions would kick in earlier in the budgetary surveillance process, and public debt would also be taken into account, alongside the existing deficit criterion, in determining whether EMU members were abiding by the rules. Third, the establishment of a permanent crisis mechanism (the European Stability Mechanism—ESM) was proposed to safeguard the financial stability of the euro area. EU Council President Herman Van Rompuy committed himself to open consultations with the member states on a limited treaty change required to establish such a mechanism. In the mean time, the Irish crisis pushed Irish Prime Minister Brian Cowen, after months of initial delay, to apply for an €85,000m. bailout from the EU and the IMF in November 2010 and to announce a general election, which took place the following spring, bringing in a new government.

In February 2011, European Finance Ministers formally agreed to create the permanent crisis mechanism already floated in October 2010: the ESM. The ESM would consist of a permanent €500,000m. fund that could serve as lender of last resort for all crisis-stricken eurozone countries. But, given the overall size of Italy’s outstanding sovereign debt (estimated at over €2,000,000m.) and Spain’s huge deficits, financial market participants immediately questioned whether the fund would be big enough to bail out the two larger eurozone members in trouble. (The ESM would only start functioning in September 2012, after the German Bundestag ratified it.) In March 2011, Portugal’s Prime Minister José Sócrates resigned after opposition parties rejected his proposed austerity budget. Now in a caretaker capacity, Sócrates became the third eurozone head of state to apply for an EU–IMF bailout in April 2011, when Portuguese yields rose to unsustainable levels, due to further downgrades by Fitch and Standard & Poor’s. One month later, European leaders approved a €78,000m. bailout package for Portugal, again under the condition that the Portuguese authorities implement a series of austerity measures.

During the summer of 2011, after it had become clear that the first Greek package had been insufficient, the EU member states were forced to extend another bailout package of €109,000m. to Athens. In order to further stabilize the euro as a whole, existing Greek loans were restructured, with the cost of the changes being passed on to private bondholders, who agreed to take a significant ‘haircut’ in a voluntary debt swap deal. The first selective government default within the eurozone became a fact.

In August 2011, pressure mounted on the coalition of Italy’s Prime Minister Silvio Berlusconi, as 10-year Italian government bond yields surpassed 6%, which were widely judged by the markets to be untenable given the country’s high debt. After a joint letter by ECB President Jean-Claude Trichet and (then still) Bank of Italy Governor Mario Draghi asking the Italian Government for ‘immediate and bold’ measures, Berlusconi responded by proposing €45,000m. in spending cuts and tax increases in an effort to calm the markets. Undeterred by protests and a one-day general strike called by Italy’s largest labour union, Italy’s legislature eventually approved a revised austerity package of €54,000m. with the intention of balancing the country’s budget by 2013. But constant redrafting of the budget had exposed the fractious and unstable centre-right coalition that Berlusconi was leading and the major credit rating agencies responded by downgrading Italy in September 2012, citing political uncertainty (Jones 2012a, 1–5).

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As anti-austerity protests and riots swept across Southern Europe, European leaders met in Brussels in late October 2011 to discuss another ‘comprehensive solution’ to the crisis, with Sarkozy and Merkel privately negotiating with Greek bondholders, which resulted in a bond swap that would effectively halve the total value of all Greek debt. A few days later, Greek Prime Minister Papandreou—in despair—called a referendum on the bailout plan, sending shockwaves across global financial markets. European leaders, irked by Papandreou’s populist theatrics, responded by saying openly for the very first time that Greece would have to choose whether it wanted to stay in the eurozone, or leave. Papandreou was forced to abandon his referendum idea, and his position became increasingly tenuous, forcing him to step down a couple of days later.

In November 2011, the eurozone witnessed three changes of government, in Greece, Italy and Spain. In Athens, Papandreou resigned and was replaced by Lucas Papademos, an unelected technocrat and former vice-president of the ECB. In Rome, Berlusconi effectively lost his majority and proposed to resign under the condition that the legislature approve his austerity budget for 2012, which it duly did on 12 November. Mario Monti, another unelected technocrat and former European Commissioner, took over from Berlusconi with markets initially responding negatively as Monti’s government formation was delayed. On 20 November, Spain voted out the socialist Government of José Luis Zapatero, and Mariano Rajoy, leader of the Popular Party (PP), was tasked with forming a new government.

In December 2011, exactly 20 years after Maastricht, European heads of government met in Brussels for a summit that promised to reshape the European Union. But, while many far-reaching changes to the institutional design of the EU were proposed, the major outcome was nothing more than a new Fiscal Pact that stipulated additional penalties for countries exceeding budget deficit benchmarks. British Prime Minister David Cameron, unable to secure regulatory exemptions for London’s financial sector, refused to sign on to the new Fiscal Pact. Also, the Czech Republic decided not to participate. The summit was dubbed a failure in the financial press, even though 25 out of 27 member states vouched to press ahead with the required treaty changes. The gap between the UK on the one hand and France and Germany on the other appeared wider than ever, at a moment when European unity was needed the most.

A week after the December summit, the European Central Bank’s newly installed president, Mario Draghi, who had succeeded Trichet at the end of his term, surprised markets and policymakers alike by announcing an early Christmas present in the form of unlimited Long Term Refinancing Operations (LTROs). Right after Draghi’s announcement, more than 500 European Banks took up the ECB’s offer, which added up to €489,000m. in three-year loans during this first round. Draghi justified the LTROs as designed to prevent a credit freeze. Their widespread adoption by European banks demonstrated, initially, a marked improvement in sentiment of the private banking sector, which so far had assumed that the ECB would not be making the kind of direct capital injections that had characterized the Federal Reserve’s response to the banking crisis in the USA. The ECB’s new approach would again bring a couple of months of calm to the markets, especially after a second round of LTROs was injected into the European banking sector in late February 2012.

In March 2012, there was the signing of the new pact on fiscal discipline by 25 of the 27 EU members, with the UK and Czech Republic opting out, as well as another Greek bond swap, which wiped out about €100,000m. of Greek government debt. Unlike in July 2011, this Greek debt restructuring was involuntary, and therefore triggered the pay-out of a couple of billion euros in credit default swap (CDS) insurance, which was actually smaller than originally feared. The new Spanish Government led by Mariano Rajoy announced its budget later that month, which shaved 10% off of the previous year’s budget, leading to a series of violent
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protests in Madrid and Barcelona, as well as a general strike in the country. The eurozone’s finance ministers in the meanwhile agreed to expand the EFSF and ESM to have access to a total amount of €800,000m. in order to be able to cope with potential bailouts for Italy and Spain.

Financial market concerns returned to the eurozone in full force in May 2012 as anti-austerity candidates won national elections in both France and Greece, and in regional elections in Italy. Beppe Grillo, an anti-austerity comedian who founded a protest party in Italy, did very well in local elections in Italy, along with the Communists and Greens. More significantly, socialist candidate François Hollande beat Nicolas Sarkozy to become the new president of France, on a platform that rejected the fiscal austerity course for the eurozone followed by his predecessor and his German counterpart Angela Merkel. But, from a financial market point of view, the most important election was taking place in Greece. The same day that Hollande conquered the Elysée Palace in Paris, Greece rejected its mainstream pro-austerity parties PASOK and NDP in favour of SYRIZA, an amalgamation of small left-wing parties who ran on renegotiating Greece’s bailout with the EU. Since no coalition was able to come out of those elections, new elections were scheduled for the following June. Talk of ‘Grexit’ (a Greek exit from the eurozone) became louder as Greek deposit holders started to withdraw their money from banks and capital flight out of Greece reached record levels. The crisis suddenly entered an acute new phase.

In June 2012 the Spanish Government, after it was forced to nationalize Bankia, the country’s largest mortgage lender, requested €100,000m. in financial assistance from the EU to recapitalize its ailing banking system. While Spanish Prime Minister Rajoy sought to downplay the package as some sort of ‘soft loan’ from the EU with no strict conditionality, rather than a bailout, the euro ‘troika’ (EU, ECB and IMF) was quick to point out that they would oversee the loan and any conditions that would be applied to it. Greeks returned to the polls and voted in a new grand coalition of NDP, PASOK and the Democratic Left, with Antonis Samaras becoming the new prime minister. He immediately embarked on a fresh round of austerity measures in order to secure the next tranche of bailout money. Although markets initially celebrated the Spanish bailout and the outcome of the Greek election, the euphoria would once again be short lived. In a matter of days, Cyprus became the fifth eurozone member to apply for a bailout.

At the end of the month of June, the 20th EU summit in Brussels since the beginning of the euro crisis finally saw something of a breakthrough. Rajoy and Monti secured more favourable lending terms for their countries, as eurozone leaders agreed that loans from the ESM would not be subject to troika oversight. Also, in addition to some modest growth stimulus measures such as €5,000m. in project bonds, the first steps were taken to establish a eurozone-wide banking union, with common supervisory oversight powers of eurozone banks—a Single Supervisory Mechanism (SSM)—with a key role for the ECB in Frankfurt (European Commission 2012).

The summer of 2012 was marked by continuous protests in Spain, Italy, Portugal and Greece, as all four countries pressed ahead with their fiscal and labour market reforms. Markets remained unconvinced of the feasibility of those countries’ strict budgetary measures, as all four countries were in recession and saw their debt-to-GDP ratios go up further, the logical but perverse consequence of harsh austerity measures aimed at reigning in debt. This set the stage for Mario Draghi to enter the limelight and try to take control of the crisis. On July 26, he gave a speech at the Global Investment Conference in London, reassuring his audience—and the markets—with the following words: ‘Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough’ (emphasis added) (ECB 2012).
Financial markets rallied. In early September 2012, Draghi made good on his promise by unveiling a bond-buying plan that would be a 'fully effective backstop', also clearly stating the euro to be 'irreversible' (BBC 2012). For the first time, the ECB showed its willingness to intervene directly in the bond markets of Italy and Spain by 'outright monetary transactions' (OMTs), which would have the effect of lowering Spanish and Italian interest rates and reassuring the markets that the ECB would indeed do 'whatever it takes' to save the eurozone.

Meanwhile, the eurozone as a whole slid further into recession, and EU leaders made very slow progress towards a full banking union, with Germany postponing the launch date to some time in late 2013 or early 2014. The ECB’s decision brought some relief to markets as well as EU officials. However, it was not clear that it would last, given that all the big institutional decisions (banking union, closer fiscal union, political union) were postponed to a later date.

By the autumn of 2012, after three full years of eurozone crisis, it became clear that, for all its obvious economic problems that had pretty straightforward solutions, this was first and foremost a political crisis for which there was no easy solution. The political economy of the European monetary union did not just turn out to be a merely technical matter. At the heart of the crisis was a complex interplay of different national and supranational players’ conflicting interests; power tensions and a game of chicken between private bondholders and public sector debtors; incomplete eurozone and EU institutions lacking real power; and a debate between differing economic philosophies, or paradigms, which will be discussed in the next section.

Assessing the EU response: players’ diverging interests, (lack of) power of incomplete institutions, and unsustainable paradigms

The euro crisis has been multifaceted and complex. The main players included the eurozone member states and international institutions like the EU, the IMF and the ECB. However, other actors also played key roles in its theatre, such as: the UK, the USA, the big emerging market economies of China, India and Brazil, the Group of Twenty Finance Ministers and Central Bank Governors (G-20), and of course, financial market participants and the financial press. Looking at the main events as they unfolded from late 2009 onwards as outlined in the previous section, and the various crisis responses that were agreed to in more than 20 EU summits over the span of those three years, one can see that the answers to the euro crisis were a compromise of competing interests and ideas, with imperfect eurozone institutions at its heart.

The different crisis narratives from section two at various times informed the interests of the different players as well as the responses of the European institutions and policymakers. Since the euro crisis dominated world financial news headlines for most of those three years, it would be impossible to pin the crisis down by simply looking at it as a conflict of interests, a crisis of institutions or a battle of economic ideas. One must look at the crisis through the lens of all three explanatory factors—players, power and paradigms—in order to make sense of what happened. Understanding the overlap of interests, institutions and ideas, and their contribution to the various EU solutions, will be crucial to its conclusion. Let me now consider these three factors one by one.

First, numerous scholars have looked at the process of European integration from an interest-based perspective (Hoffmann 1966; Frieden 1991; Moravcsik 1998; Milward 2000). Their analysis is ‘state-centric’, in that they see EU member states as the main players in deciding whether to give up sovereignty to the supranational institutions of the European Union. As long as it is in the material interest of states to give up sovereignty, they will go ahead with further integration; when material gains are insufficient, the integration process will stall. The clear clash of interests during the sovereign debt crisis was between the surplus eurozone members of
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Northern Europe, including Germany, Finland and the Netherlands, who took a hard line on any requests for EU bailout money, and deficit Southern eurozone members, including Portugal, Spain, Italy and Greece, but also Ireland, who were being targeted by financial markets. This divergence of interests can also be seen from a creditor versus debtor point of view, with the Northern banks being the main creditors and holders of Southern sovereign debt, and the South having built up substantial public and private debt mainly owed to the North. This division has no clear place for France, which sits somewhat uncomfortably in the middle, since its banks were heavily exposed to Mediterranean sovereign debt, making it a creditor nation, but its policies and deficits were closer to Southern Europe, which occasionally put it at the mercy of the financial markets itself, just like Italy or Spain. France, more than any other EU member state, also has a keen interest in maintaining a close relationship with Germany as together they had traditionally formed the joint engine of European integration.

However, it is not immediately clear who controls the agenda in a creditor versus debtor conflict. To paraphrase Keynes, ‘if you owe the bank one hundred pounds, you have a problem; but if you owe the bank a million pounds, the bank has a problem’. The creditors usually are in a somewhat stronger position since they can impose certain conditions on their debtors in order to be paid back, but they have to be careful not to be too harsh since they risk losing everything in the case of a sovereign default. The debtors’ main interest is to maintain their creditworthiness with international financial markets, and they will therefore go to considerable lengths to sort out their fiscal situation. But, in the short term, cutting spending and increasing taxes—the standard economic technique to improve a country’s fiscal situation—actually worsens their budgetary position by causing a recession.

At the same time, what complicates things is that eurozone members are also each other’s most important trading partners. A recession in one country will have knock-on effects in other member states. Since Germany found itself in the stronger position—being Europe’s paymaster, having the eurozone’s largest economy and holding a significant amount of PIIGS sovereign debt—it was in some sense able to dictate the terms of the bailouts and attach strict reform conditions, premised on the need to avoid a similar crisis in the future. But, since all member states, especially Germany, had a vested interest in keeping the euro together—for historical, political and economic reasons—the need to compromise was crucial. In game-theoretic terms, there were multiple equilibriums possible between the players, but some were more favourable towards creditor nations, while others were more favourable towards the debtors. Thus, from a state-centric interest point of view, the outcome of the euro crisis would be the result of the efforts of EU institutions to balance competing players’ interests and find an acceptable compromise for all players involved.

The second approach to looking at why certain decisions were made is from an institutional lens. From this perspective, it is no surprise that the old contest between ‘EU integrationists’, who want to see a stronger role and more power for the EU Commission, and ‘inter-governmentalists’, who want to keep the main decision-making power in the European Council (comprising all EU heads of state), flared up once again during the eurozone crisis. The Maastricht Treaty had created a monetary union without a real fiscal union, no banking union and a ‘no-bailout’ clause, and therefore did not contain the institutional tools necessary to deal with a crisis of this nature. Money moved around freely between the eurozone member states’ banks but was still regulated at the national level. Furthermore, the sole mandate of the ECB was to maintain price stability—a rate of inflation close to, but below, 2%—and Frankfurt lacked the far-reaching powers of the Federal Reserve in the USA to calm the markets through quantitative easing. Lastly, the Stability and Growth Pact (SGP), the surrogate for a real fiscal union, had been broken by France and Germany in 2003, and did not have real teeth. But even
if it had been adhered to by all member states, it was obvious that it would not have prevented the eurozone crisis from happening, especially since Ireland and Spain had been running substantial fiscal surpluses—not deficits—during the years preceding 2010. Moreover, the overall structure of the EU by definition makes it hard to deal with real-time financial crises. The eurozone’s ‘hyper consensus’ model on fiscal and financial issues means that consensus development is much like herding cats: 17 finance ministers have to agree on a joint response, rather than just one Treasury Secretary, as is the case in the United States (Hix 2008).

The main institutional innovations during the crisis were incremental rather than radical, underlining the path-dependent nature of EU integration, at a time when more radical changes were probably needed to take full control of the crisis at the EU level. The centrepiece of those institutional efforts was the new Fiscal Pact, which was signed in early 2012 by 25 of 27 EU member states. The Fiscal Pact really was nothing more than a stricter version of the SGP, with a heavier emphasis on balanced budgets and quasi-automatic sanctions that would be harder in the future to ignore. However, there was a lack of real progress on correcting for external imbalances and no agreement on establishing a European rating agency to compete with the three main American ones. On the most important institutional questions—a catch-22 where Germany wants closer ‘political union’ before committing to Eurobonds, while France insists on an ‘economic government’ and the establishment of Eurobonds before committing to a political union—little progress was made. However, the EU–wide banking union and Single Supervisory Mechanism will probably see the light of day in 2014 with expanded regulatory powers for the ECB, but is unlikely to be sufficient to solve the crisis. The main flaw of institutional design—that of an incomplete monetary union which lacks a real fiscal and financial union—remains and is unlikely to be agreed on as long as nation states insist on keeping their monopoly power over taxation and spending.

The third approach to understanding the various eurozone responses to the crisis is ideational or from the point of view of different paradigms. This approach says that the euro crisis, at its heart, was a battle of ideas. Given the environment of high uncertainty and complexity, the way the crisis was described or narrated was just as important as the objective facts themselves. This paradigmatic approach suggests that, to understand any solution to the crisis, one needs to look at which economic ideas informed Europe’s decisions and why.

Throughout the crisis, there was constant tension between two opposing economic paradigms. On the one hand there was what one could call the ‘French-Mediterranean’ Keynesian view, which emphasized growth, a European economic government, the need to avoid IMF involvement at all cost, and arguing that similar crises in the future should always be solved by political actors. On the other hand, there was the ‘German-Northern European’ Ordoliberal view, which emphasized price stability and national fiscal discipline, the need for IMF conditionality and technical assistance for any bailout, and quasi-automatic rules to deal with similar crises in the future. Given Germany’s growing position of strength during the euro crisis, the ideas held by its policy elites proved crucial when putting together a joint response. Hence, one can see Germany’s influence in the eurozone response in the heavy emphasis on ‘putting one’s fiscal house in order’ and regaining competitiveness by cutting wages (crisis narratives number two and three), rather than focusing on fiscal solidarity, intra-EMU imbalances or the creation of Eurobonds (crisis narratives one, four, five and six).

The irony of this strategy, of course, is that it rests on a rather partial reading of what caused the crisis in the first place. In the case of Ireland for example, it is hard to understand why a fiscally sound country which had slashed public spending and public sector wages in response to the 2008 financial crisis, well before the eurozone sovereign debt crisis emerged, could solve a banking crisis with even more austerity measures. Yet, that is what all countries that requested a
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bailout ended up doing. There is a fallacy of composition at the heart of this logic, namely that the debtor countries should all become more like Germany. But this is of course impossible. The rest of Europe cannot become more like Germany if the whole point is that Germany could only be Germany because the others were not. Not everyone can be a net exporter by saving more than they invest. We still do not trade with Mars or Venus. Any current account surplus means that another country has a current account deficit. Any creditor nation needs a debtor nation (Matthijs and Blyth 2011). As long as austerity was the only answer, the crisis would worsen in the short term, with debt-to-GDP ratios increasing, as they had in the case of the Mediterranean eurozone members, with the markets responding by charging higher interest rates, which would only exacerbate the problem. Thus, with the German paradigm holding sway and informing the main narrative of the eurozone crisis, all other possible solutions would be ignored.

The euro’s prospects and lessons for global governance: balancing the demand for legitimacy with the need for effectiveness in order to stay relevant

Given the clash between competing interests, weak institutions and contradictory ideas, it should be no surprise that the eurozone sovereign debt crisis has lasted as long as it has, and continues to last at the time of writing. Since—with the notable exception of the Belgium-Luxemburg Economic Union (BLEU)—no multi-state monetary union has ever survived without some kind of political union, there are also no good historical examples from which to learn. The logic of a fully functioning monetary union rests on a solid supranational institutional foundation that the eurozone still lacks. The ECB can bring temporary relief by intervening in the bond markets, but cannot be a substitute for real fiscal and political integration, at least not permanently. As Benjamin Cohen summed it up in the opening quote of this chapter, Europe is caught between the centrifugal logic of domestic politics and the centripetal demands of a supranational currency union. While Eurosceptic analysts who expect the euro to fail underestimate European elites’ commitment to European integration, Europhile observers overestimate the willingness on the part of those same elites to give up their fiscal sovereignty. The balancing act remains arduous and needs to marry the conflicting demands for democratic legitimacy (which remains at the national level) and the absolute need for policy effectiveness (which can only be achieved at the supranational level). The most likely outcome in the short and medium term therefore can only be ‘muddling through’ (Cohen 2012).

However, ‘muddling through’ does not guarantee that the euro experiment will eventually stumble its way to success. Indeed, the crisis—far from over—may lead to even greater divergence, with some suggesting that dissolution is the only outcome. More immediately, the markets may force the hand of EU leaders. Short-term national interests, informed by misguided ideas, may trump the need for long-term institution-building. In other words, things may need to get worse before they get better: as long as there is no real existential crisis it is unlikely that the European Union will make a dramatic step towards closer political integration, since the short-term costs would be substantial. However, many EU integration observers believe that Europe has emerged stronger out of every past crisis and has always responded with closer integration and new institutions.

That may well be true, but this crisis may also really be qualitatively different from previous ones. Giving up sovereignty over fiscal policy goes to the heart of what the modern nation state is all about; and the nation state is still, for better or worse, where democratic legitimacy lies. What the euro crisis has underscored is that monetary policy is not a mere ‘technical’ issue, as

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was believed in the early 1990s, but an issue that many believe should be subject to democratic oversight (McNamara 1998); thus it becomes a political issue as well. Nevertheless, as hard as it is to expect Europe’s leaders to give up their powers in fiscal affairs voluntarily, as they have done in monetary affairs, it is just as difficult to imagine them willingly letting the eurozone collapse. The commitment of EU elites to the project of European integration remains as strong as ever, and no politician wants to be responsible for its failure. If the crisis gets a lot worse, an effective comprehensive solution, that is fiscal and political union, could well be agreed upon.

The lessons for global economic governance are threefold. First, monetary and financial policy is not purely a technical matter as it was believed to be at Maastricht. What central banks do in times of financial crises directly affects the lives and welfare of ordinary citizens. For this reason, which powers central banks have, and how transparent their decision-making is, will always to some degree be influenced by pressure from national governments, and governments in turn by pressure from the public through legitimate democratic processes (as we saw with the election of anti-austerity parties in Greece and France). Moreover, giving up monetary powers to a supranational central bank means giving up inflation and devaluation at the national level, which are two powerful financial tools in a time of crisis. Most countries in the future will think twice before they decide to do so. Thus, the euro crisis showed that a financial crisis at the regional level is highly political. Trying to apply a technical fix to what is ultimately a political problem will not work. The political aspect must be acknowledged and addressed from the start.

Second, do not start a monetary union without a working fiscal and banking union, common deposit insurance and a common debt instrument. While the institutions of the eurozone worked well enough during the upswing of the economic cycle, it proved incapable of dealing with the multiple demands of a full-blown financial crisis. Because of the negative experience with the incomplete institutions of the eurozone, other regional arrangements in the world like Mercosur in Latin America and ASEAN in South East Asia will be careful not to take too many bold and simultaneous steps towards closer economic integration.

Third, global or regional financial crises do not automatically lead to major institutional reforms that prevent similar crises from happening in the future. The problem of collective action at the international level remains as acute as ever, as the lack of action at the G-20 level has illustrated since 2010. Also, it is difficult to build global or regional institutions from the top down, even if there were international agreement on the form they should take and the mandate they should have. Domestic regulatory regimes inform regional arrangements, and regional arrangements will have to inform global ones.

Conclusion

In many ways a logical consequence of the global financial crisis that started in the US housing market in the summer of 2007, the European ‘sovereign debt crisis’—as it quickly became known—raised serious questions about the original design and long-term viability of Europe’s Economic and Monetary Union, and cast a dark shadow over the success of the European integration project itself. This chapter discussed seven contending and overlapping crisis narratives that informed at various times how Europe’s heads of state and their finance ministers cobbled together various ad hoc bailout responses throughout 2010, 2011 and 2012, and at the same time tried to come up with a more permanent solution to avoid similar financial crises in the future.

To make sense of the various policy responses and compromises, the chapter focused on three principal theoretical lenses: the diverging interests among the various players, the relative
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(in)effectiveness and power of Europe’s supranational institutions to deal with ‘real time’ financial crises, and the battle of economic paradigms at the heart of the crisis in trying to determine how the eurozone should be governed in the future. Since disintegration and more radical reform of EU institutions are unlikely for multiple reasons, continued muddling through with only gradual, incremental steps towards further integration will continue in the medium term. But that does not mean that the euro will continue in its current form.

This chapter also discussed three lessons from the euro crisis that are informative for global governance issues: money is not a technocratic issue, but a political one subject to democratic control; monetary unions without an economic government, fiscal transfers or a common debt instrument will be at the constant mercy of financial markets; and financial crises do not always lead to major institutional responses, either national or global, that will prevent them from happening in the future. The main difficulty lies with resolving the tension between demands for democratic legitimacy at the national level with the need for policy effectiveness at the supranational level.

Economic integration needs strong institutions to survive and, as the euro crisis affirms, supranational institutions add a layer of technical and political complexity beyond the immediate ken of the traditional nation state and the public that it serves. As this chapter has demonstrated, interests, ideas and institutions all have a role to play in this theatre of economic convergence. How ideas inform interests, and what institutions these interests choose to uphold, will not only colour the details that define global economic governance, they will also determine whether the eurozone crisis was a mere growing pain or whether it was doomed from the start.

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The future of the dollar?¹

Miinh Ly

Introduction

The dollar has a unique status in the global financial system. Besides being a national currency that is used by US citizens, the dollar is the dominant ‘international reserve currency’ that is relied on world-wide to price and pay for commodities, global trade and debt. This chapter has two aims. First, it develops a distinct institutionalist explanation for why currencies attain international reserve status. The chapter then applies the institutionalist explanation to debates about the future of the dollar compared to its potential rivals. Second, the chapter reviews why the legitimacy and effectiveness of the dollar’s reserve currency status have been challenged.

The dollar’s status as the leading international reserve currency has long been criticized as being an ‘exorbitant privilege’, in the words of Charles de Gaulle’s finance minister, Valéry Giscard d’Estaing (Eichengreen 2011, 4). The dollar’s role as the reserve currency has allowed the USA to maintain the largest current account deficit in history, consuming far more than it produces. From 2001 to 2008, the USA borrowed US $5,000,000m. from foreigners (Chinn and Frieden 2011, 14–15). Foreigners have been willing to lend to the USA because it provides the reserve currency or dollars they need to pay for international transactions.

The dollar’s reserve currency privilege has come under even greater scrutiny following the global financial crisis. As Moschella and Weaver describe in their introduction to this volume, ‘the global financial crisis incited serious reflection on the legitimacy, relevance and effectiveness of the core ideas, rules and structures that have governed the world economy’. The dollar has not been exempted from these challenges to the structure of global economic governance.

In response to concerns about the dollar, discussion has turned to possible alternative or supplemental international reserve currencies. Some writers believe that the euro could eventually rival—though it may not surpass—the dollar (Eichengreen 2011; Chinn and Frankel 2005). Others, such as the Governor of the People’s Bank of China, Zhou Xiaochuan, argue that the global economy should shift away from the dollar and instead use International Monetary Fund (IMF) ‘special drawing rights’ or SDRs (Zhou 2009). The SDR proposal has been endorsed by the United Nations Commission of Financial Experts, led by Joseph Stiglitz (Stiglitz 2010, 157–90). An expanded role for SDRs was also suggested by the Managing Director of the IMF in 2011 and by President Sarkozy of France when he chaired the Group of
Eight (G-8) and Group of Twenty Finance Ministers and Central Bank Governors (G-20) (Sarkozy 2010; Strauss-Kahn 2011). The IMF’s Articles of Agreement have stated since 1978 that it shall be the ‘objective’ of all members to make ‘the special drawing right the principal reserve asset in the international monetary system’. A greater role for either the euro or the SDR would expand the players of the international reserve currency system and give greater power to the European Central Bank (ECB) or the IMF.

To evaluate the future of the dollar compared to its possible rivals, the chapter begins by surveying the prevailing market, instrumental and geopolitical explanations of reserve currency status. These views have focused on the governments or private investors that demand a currency. In contrast to these explanations of reserve currency status, the chapter offers an ‘institutionalist’ approach that emphasizes the importance of the institutions that supply a currency, such as the US Federal Reserve, which issues the dollar.

The institutionalist approach argues that institutions can enhance a currency’s reserve status in two ways. First, they can intervene quickly as the lender of last resort during financial crises. These interventions ensure that there is enough liquidity, or an adequate supply of the currency for international transactions. Second, institutions can promote the economic growth that is needed for a currency to maintain its stable value. If institutions fail to support economic growth, a prolonged recession can undermine the currency’s value by making it more difficult for the government to service its debt.

The chapter then applies the institutionalist explanation to debates over whether the dollar will remain the world’s dominant international reserve currency. It asks whether the euro and SDR are backed by institutions that can guarantee liquidity and intervene in financial crises. The chapter argues that the IMF and ECB are currently unable to perform these institutionalist functions. The ECB is limited in its ability to support the euro because of its single mandate to control inflation. The euro is also constrained by the lack of institutions that can provide the automatic stabilizers and fiscal stimulus needed to counter recessions. By contrast, the Federal Reserve acted decisively to supply dollar liquidity and strengthen the economy during the 2007–09 financial crisis.

The institutionalist shortcomings of the ECB and IMF undermine the ability of the euro and SDR to challenge the reserve currency status of the dollar, at least for the foreseeable future. However, while the dollar may be a more effective reserve currency for the time being, the chapter raises concerns about the legitimacy of the dollar-centred system, compared to the potentially fairer and more multilateral SDR.

Four approaches to reserve currency status

The dollar is the leading international reserve currency, making up the largest part of the foreign exchange reserves that governments draw on to pay their international debts. Central banks hold more than 3,700,000m. US dollars in official central bank foreign exchange reserves, compared to only 245,000m. worth of pound sterling, 247,000m. of Japanese yen and 1,400,000m. of euros (IMF 2012). The dollar is also the most common currency to invoice and settle—to price and pay for—international trade, even when that trade does not involve the USA. While only 12% of trade is with the USA, nearly half of international trade is invoiced in dollars (Williamson 2012, 2; Goldberg 2008). The major commodities, such as oil, wheat, and rubber, are all priced in US dollars (IMF 2011a, 17).

This chapter asks whether the dollar’s status as the leading reserve currency might be challenged by the euro and SDR. The chapter places the dollar, euro and SDR in the context of four approaches to reserve currency status. The first three—the market, instrumental and
geopolitical—are taken from *The Future of the Dollar*, edited by Eric Helleiner and Jonathan Kirshner. The fourth approach, what I call the ‘institutionalist’, claims that institutions can enhance the reserve status of a currency. Institutions can create liquid markets, promote economic growth and intervene quickly in financial crises. While these four explanations are not mutually exclusive, they are distinct in underscoring different determinants of reserve status.

**The institutionalist approach to reserve currency status**

The market-based approach is taken by economists who emphasize the importance of private actors as the main players in selecting an international reserve currency. This approach assumes that private actors—such as investors in the bond market, export-importers or commodity traders—make decisions to use a currency based on its economic attractiveness compared to other currencies (Helleiner and Kirshner 2010, 7). The economic attractiveness of a currency depends on (1) its stability as a store of value; (2) its liquidity or the availability of capital in that currency; and (3) its network externalities or the fact that many other market actors are already using the currency, making transactions in it more convenient (Helleiner and Kirshner 2010, 7–11). Confidence in the dollar, under a market-based approach, would be undermined by rising current account deficits and greater government debt.

While the market-based approach emphasizes private actors, the second, instrumental approach focuses instead on foreign governments as the main players. According to the instrumental approach, governments select a reserve currency to pursue national economic goals (Helleiner and Kirshner 2010, 12). For example, foreign governments may be motivated to support the dollar based on the Bretton Woods II theory or the monetary peg theory. The Bretton Woods II theory of Michael Dooley, David Folkerts-Landau and Peter Garber claims that exporting countries like China and Japan buy US treasuries with the economic goal of preventing their national currencies from appreciating. Buying US treasuries stimulates demand for the dollar and lowers the value of the renminbi and yen by comparison. A lower value for the renminbi and yen makes Chinese and Japanese exports cheaper and more competitive in the US market (Helleiner and Kirshner 2010, 12; Chinn and Frieden 2011, 17–18). Another instrumental account of reserve currency status is given by Ronald McKinnon’s monetary peg theory. It claims that countries peg their currencies to the dollar as a means of stabilizing their price level, preventing significant inflation or deflation (Helleiner and Kirshner 2010, 13; Ronald McKinnon 2010, 45–68, esp. 64).

A third approach that seeks to explain why currencies gain or lose international reserve status is the ‘geopolitical’ explanation. It shares with the instrumental approach the focus on states as the main players. However, the geopolitical approach differs in claiming that foreign governments decide to support a reserve currency based on considerations of security, political power and military alliances (Helleiner and Kirshner 2010, 15–17). For instance, Kirshner proposes that Western Europe and Japan supported the dollar in the Cold War because of their alliance with the USA. But now that the Soviet threat is gone, the alliance has weakened. In Kirshner’s view, Western Europe and Japan are less likely to bolster the dollar and are more interested in expanding the international status of the euro and yen (Helleiner and Kirshner 2010, 15–16; Kirshner 2010, 195).

The fourth, ‘institutionalist’ approach argues that a currency’s reserve status may be bolstered by the institutions that issue or back a currency, such as the central bank or the government more generally. The institutionalist approach emphasizes the institutions that supply the currency as the major players. It contrasts with the instrumental and geopolitical perspectives, which focus on the foreign governments that potentially demand the currency. The
institutionalist approach also contrasts with the market-based perspective in showing how confidence, liquidity, stable value and network externalities are not determined solely by private actors in the market. Rather, these market factors can be supported or undermined by institutions. After describing in greater detail the institutionalist approach, I will apply it to debates over the future of the dollar compared to its potential rivals, the SDR and euro.

How the Federal Reserve, as an institution, enhanced the dollar’s reserve status

To see how institutions might enhance the international role of a currency, consider the Federal Reserve’s actions to increase dollar liquidity after the recent financial crisis. Since the dollar is the international reserve currency, it is crucial for foreign businesses and banks to be able to borrow funds in dollars. For example, when a South Korean company imports goods from Thailand or services its bonds, it generally does not pay in South Korean won, but rather in US dollars. Most exports from South Korea and Thailand (80%) are priced in dollars, even though only 20% of those goods go to the USA (Eichengreen 2011, 168; Goldberg 2008, 2). For businesses and banks to service their international debt, they need access to dollars. The problem is that, during a financial crisis, banks and financial markets are unwilling to loan dollars, causing a shortage of dollar liquidity. If the shortage persists, businesses and banks may be unable to pay their debts and face bankruptcy.

The key institutional role of the Federal Reserve in a financial crisis is to ease the shortage of liquidity by lending dollars on a massive scale. As the Chairman of the Federal Reserve, Ben Bernanke, declared in a speech, ‘serving as a “lender of last resort” has been central banks’ key weapon against financial panics for hundreds of years’ (Bernanke 2010a). Although foreign central banks may loan dollars out of their foreign exchange reserves, there is a danger that their reserves may be exhausted in a financial crisis. If a foreign central bank’s dollar reserves drop below a safe minimum—the most common standard being dollar reserves sufficient to pay for at least three months of imports—there may be a mass sell-off or run on the central bank’s national currency, deepening the financial panic (IMF 2011).

The Federal Reserve’s solution to this problem was to meet the world’s demand for dollar liquidity by establishing ‘central bank liquidity swap lines’, beginning in 2007–10 and extended from 2010–14 (Bernanke 2010b). The swap lines provided dollar liquidity for 14 central banks, including the European Central Bank, the Bank of England, the Bank of Korea and the Bank of Japan (Board of Governors of the Federal Reserve System 2011). Drawing on the swap lines, a foreign central bank could sell its national currency to the Federal Reserve in exchange for dollars. The dollars could then be loaned to a country’s banks and businesses, easing the dollar liquidity shortage and stemming the threat of widespread bankruptcy. After an agreed-upon time period, 1 to 84 days later, the foreign central bank is obligated to buy back its currency at the same exchange rate, returning the dollars and paying a market-based interest rate to the Federal Reserve.

The largest amount of dollars that the Federal Reserve extended at any one time in swaps was US $580,000m. in December 2008 (Fleming and Klagge 2010). But what is less widely known is that the cumulative value of the 569 swap lines extended from 2007–10 was over $10,000,000m. ($10,057,401,900,000) (Board of Governors of the Federal Reserve System 2011). This money was lent over three years and not simultaneously, and it was all paid back with interest. The total size of the swap lines, amounting to $10,000,000m. worth of transactions, indicates the major institutional role of the Federal Reserve in promoting the international reserve currency status of the dollar. The Federal Reserve supported the dollar’s reserve status by guaranteeing sufficient dollar liquidity during the financial crisis.
The Federal Reserve has also supported the dollar’s international reserve status by taking steps to increase economic growth in the USA. Economic growth is one of the essential conditions for public debt to be sustainable (the other conditions being that government spending does not rise too quickly, that interest rates on the debt are low enough to be affordable and that government revenue through taxation does not fall too sharply, such as through excessive tax cuts). Economic growth contributes to debt-servicing by increasing government tax revenue. Individuals and businesses pay more taxes when their incomes rise with higher rates of economic growth. For example, the IMF Fiscal Affairs Department calculates that if a country with a 100% debt-to-gross domestic product (GDP) ratio increased its economic growth by just one percentage point for 10 years, it would lower public debt by 29% of GDP. Its debt would fall to a more sustainable 71% debt-to-GDP ratio without higher tax rates or cuts in government spending (Cottarelli 2012, 32). Conversely, small reductions in economic growth can quickly raise a country’s debt burden by reducing tax revenue.

Economic growth is crucial not only to paying public debt, but to making public debt sustainable at all. Public debt tends to accumulate over time because of interest, even if government spending is held constant. For the debt to GDP ratio to be reduced, the rate of economic growth must surpass the interest rate on the debt. The danger is that ‘the debt will continue to grow indefinitely … if the interest rate is larger than the growth rate of the economy’ (Contessi 2012, 205, 215). In that case, the debt would increase faster than the ability to pay it down.

An unsustainable debt-to-GDP ratio may undermine the international reserve status of a currency by threatening its stable value. As the instrumental view points out, private investors may switch out of a currency if its long-term value is in question. They could sell off the currency, out of concern that rising debt would eventually lead the government to default or use inflation as a means of reducing the debt’s real value. Inflation (also known as ‘monetizing the debt’) or default would sharply cut the real value of private investors’ currency holdings.

What the institutionalist approach adds is that the institutions issuing a currency can intervene to encourage economic growth. Greater economic growth makes public debt more sustainable, supporting the stable value of the currency. For example, the Federal Reserve has engaged in four rounds of ‘quantitative easing’ to bolster economic growth since the beginning of the financial crisis. The Federal Reserve engages in quantitative easing when it purchases assets, such as treasury bonds and mortgage-backed securities (Federal Reserve Bank of St Louis 2011, 1). For instance, the Federal Reserve in its second round of quantitative easing (QE2) purchased US $600,000m. of treasury bonds. More recently, the Federal Reserve has committed in QE3 to an open-ended purchase of $40,000m. of bonds a month until the economy recovers (Appelbaum 2012, A1).

Quantitative easing aims to restore economic growth by reducing interest rates (Federal Reserve Bank of St Louis 2011, 2). When the Federal Reserve purchases large amounts of treasury bonds and other assets, it increases demand for these assets, pushing down interest rates. Lower interest rates reduce the cost of borrowing for households and businesses, stimulating greater consumption and investment. As Ben Bernanke said, when announcing the third round of quantitative easing, the goal ‘is to quicken the recovery, to help the economy begin to grow quickly enough to generate new jobs’ (Appelbaum 2012, A1). The Federal Reserve is able to pursue policies that increase economic growth because of its ‘dual mandate’. The Federal Reserve is required by law to pursue the dual mandates of ‘maximum employment’ and ‘stable prices’ or low inflation (Federal Reserve Bank of Chicago 2012).

Besides the Federal Reserve, the US government more generally can act as an institution to promote economic growth in at least two ways. First, the government can provide ‘automatic stabilizers’, such as food stamps and unemployment insurance (Krugman and Wells 2009, 362).
These measures are ‘automatic’ in that they are standing programmes for which more people qualify during a recession. They act as ‘stabilizers’ by reducing the severity of recessions. Without these stabilizers, people who are laid off during a recession would greatly cut back on their spending at supermarkets, gas stations and other businesses. These businesses would lose revenues and lay off their employees, who would cut back on their own spending, further deepening the recession.

A second way that government can promote economic growth is by using fiscal policy. Even with quantitative easing and low interest rates, banks may still be reluctant to lend, and businesses reluctant to borrow, because of low investment expectations (Blyth 2012). Few banks want to lend money for a new hotel or restaurant in the middle of a recession. To compensate for the private sector’s reduced spending, government stimulus can increase aggregate demand by using discretionary spending. For example, the USA spent US $831,000m. on an economic stimulus package (known as the ‘American Recovery and Reinvestment Act of 2009’). Although the act has been controversial, a study from Oxford Economics and Fitch Ratings indicates that the stimulus may have added 4% to US GDP (2012, 1). These results coincide with an earlier finding from Alan Blinder and Mark Zandi that the fiscal stimulus raised real GDP by 3.4% in 2010, lowered unemployment by 1.5% and added 2.7 million US jobs (Blinder and Zandi 2010, 1). The fiscal stimulus was an example of the US government acting as an institution to promote economic growth.

The important point from the institutionalist perspective is that by promoting economic growth, the US government and the Federal Reserve supported the international reserve currency status of the dollar. Economic growth reduces the debt-to-GDP ratio. A more sustainable debt contributes to the dollar’s stable value, which is one of the desirable features for an international reserve currency.

The institutionalist approach raises the question of whether SDRs or euros are backed by sufficient institutions to become a dominant global reserve currency. In the next section, I begin by defining SDRs and outlining proposals to expand their use. I then express scepticism about whether SDRs or the euro can replace dollars as a global reserve currency in the near or foreseeable future. The main problem, I will argue, is that the IMF and ECB as institutions currently lack certain key powers possessed by the Federal Reserve and US government.

Why SDRs are not currently a viable alternative to the dollar: an institutionalist criticism

(a) What are SDRs?

Since SDRs are an unusual asset, with several properties that distinguish them from a freely usable currency, I will define what SDRs are and how they are valued, before explaining why Zhou and Stiglitz have sought to expand their role. After clarifying the definition of SDRs, I will outline the proposals to expand the role of SDRs as an international reserve asset. I will then use an institutionalist approach to suggest the limits of Zhou’s and Stiglitz’s proposals to expand the role of the SDR.

The SDR is a composite reserve asset that was first created by the IMF in 1969. Its value was initially set at one SDR = 0.888671 grams of gold, then equivalent to US $1 (IMF 2010a). After the replacement of the Bretton Woods system with floating exchange rates, the IMF redefined the SDR in 1973, basing its value on a basket of 16 currencies. At first, the basket’s inclusion of many minor currencies made it excessively complex (Eichengreen 2011, 138–39). To simplify the asset and encourage its use, the IMF in 1981 narrowed the SDR’s basket to five currencies: the German mark, French franc, British pound sterling, Japanese yen and US dollar.
Today the SDR basket is composed of four currencies, with the euro taking the place of the mark and the franc. The Executive Board of the IMF reviews the percentage of the currencies in the SDR basket regularly every five years to reflect their importance to the world economy, as measured by the currencies’ share of global exports and foreign exchange reserves (IMF 2010a, 2010b). After the latest revaluation in 2010, the basket of currencies is now 37.4% euro, 9.4% yen, 11.3% sterling and 41.9% dollar (IMF 2010b).

To avoid misunderstanding, it should be emphasized that the basket serves only as a basis to calculate the SDR’s value. The SDR is not literally a bundle of currencies, such that, when a country holds SDRs, it automatically possesses a certain amount of euro, yen, sterling and dollar. Nor is the SDR backed by currencies held by the IMF. Rather, SDRs are potential claims on the freely usable currencies of other IMF members. For SDRs to be exercised, a state must first sell SDRs to another state in exchange for dollars, euros or other currencies (Eichengreen 2011, 138). SDRs cannot be used directly in transactions involving private parties, such as market intervention and the financing of international trade (Eichengreen 2011, 7, 57; IMF 2011a, 7). This is because private parties are not authorized to hold SDRs under Article XVII of the Articles of Agreement (IMF 2009a, 13). Only states that are members of the IMF and certain international organizations can hold SDRs.

Since SDRs are not privately held or traded, states cannot rely on banks or the open market to convert special drawing rights. Nor can states sell their SDRs to the IMF. The role of the IMF is limited to facilitating the conversion through either one of two means—voluntary trading arrangements or the designation mechanism. Under the voluntary trading arrangements, the IMF can match two states that want to conduct a voluntary exchange of SDRs for a freely usable currency (IMF 2009a, 14–15). If Australia wants to sell SDRs for dollars, it would contact the IMF, and the voluntary trading arrangements would find a suitable exchange partner (say, China) that would purchase the SDRs. This process typically takes 5 to 10 business days.

If there are no countries that want to voluntarily purchase SDRs in the amounts needed, the IMF can activate its designation mechanism. The IMF would designate a country with a strong external position (a current account surplus) to buy the SDRs in exchange for dollars or other freely usable currencies. However, the designation mechanism has not been activated for nearly a quarter of a century, and the IMF is reluctant to invoke it, since it would be a non-voluntary transaction on the part of the state required to buy the SDRs (IMF 2009b, 23).

(b) Why Zhou and Stiglitz want to expand the role of SDRs

Why would Zhou, Stiglitz, and the UN Commission of Financial Experts propose that SDRs replace the dollar as the leading international reserve currency? They are making an effectiveness and a legitimacy challenge to the dollar-centred system. One effectiveness challenge is that the dollar-centred international financial system is unstable. Since the end of Bretton Woods, there have been an increasing number of financial crises, with the 2007–09 financial crisis being the most severe. A major cause of financial instability is the growing imbalances that have been created by the use of a national currency, the dollar, as the dominant international reserve currency (Stiglitz 2010, 157).

The dollar’s dual functions as both a national and international currency raise a crucial problem, called the ‘Triffin Dilemma’. Named after the economist Robert Triffin, the dilemma is that the United States must run a large current account deficit to satisfy the global demand for liquidity in the international reserve currency. On the one hand, if the USA supplies sufficient dollars, the rising current account deficit will undermine long-term confidence in the dollar, threatening its value. On the other hand, if the USA does not supply the demand for dollars,
the world’s money supply will shrink, causing deflation, reducing economic growth and slowing global trade and finance (Blyth 2003, 240; Eichengreen 2011, 50–54; Stiglitz 2010, 157–58; Zhou 2009, 1).

Both Zhou and Stiglitz believe that the Triffin Dilemma could be avoided if the global economy relied on a super-sovereign reserve asset (Stiglitz 2010, 158). The asset would not be issued by a single state, or function as a national currency. Instead, it would be an international asset issued by the IMF. The Fund would regulate the supply of global liquidity according to a clear and orderly set of rules (Zhou 2009, 1). This would eliminate the problem, found in a dollar-dominated system, of the USA producing too little or too much global liquidity. The USA produces too little liquidity when the Federal Reserve reduces the money supply to fight domestic inflation, as it did in the early 1980s under Paul Volcker. This lack of liquidity places deflationary pressure on the world economy. The USA produces too much liquidity when the Fed expands the money supply to counter domestic recessions, as it arguably did in the 2000s after the dot com crash (Chinn and Frieden 2011). This places inflationary pressure on the world economy.

In either case, the problem is that the issuer of the reserve currency might pursue national economic goals that are opposed to broader global needs. If a super-sovereign reserve asset replaced the dollar, the global supply of liquidity would match global demand more closely, leading to a more stable and effective international economy. Zhou claims that ‘the SDR has the features and potential to act as a super-sovereign reserve currency’ (Zhou 2009, 2; see also Stiglitz 2010, 158).

Besides providing a more consistent source of liquidity, expanding the use of SDRs, could address the problem of maintaining the value of international reserves according to Zhou. This is particularly an issue for China, which has built up vast dollar reserves by exporting goods to the USA. It is estimated that ‘65 percent of China’s $2.5 trillion of reserves are in dollar-denominated assets’, and China controls ‘nearly half of all US treasuries in the hands of official foreign owners’ (Eichengreen 2011, 135). China is worried that its dollar reserves might drop sharply in value as a result of US debts (Stiglitz 2010, 164). The USA is running enormous fiscal and current account deficits, partly to supply the world with liquidity (as predicted by the Triffin Dilemma) and partly to finance wars and tax cuts. The USA might be tempted to inflate away the real value of its debt by expanding the money supply. Investors fearing inflation would respond by selling their dollar assets, and the value of China’s dollar reserves would plunge.

While China might preemptively sell its dollar assets before their value eroded, it would be a costly strategy. To alter its reserves, China would have to sell a massive number of treasuries, triggering the very sell-off it wants to avoid (Eichengreen 2011, 135). The solution that Zhou proposes to this difficulty would be for China to exchange its dollars for another reserve asset slowly, away from the market. An IMF ‘substitution account’ would allow China to trade its dollar treasuries for SDR-denominated bonds. China could then diversify its reserves outside the market and reduce the risk that its portfolio would be harmed by dollar depreciation (Zhou 2009, 3).

In addition to supplying a reliable source of global liquidity and attempting to stabilize the value of international reserves, another reason to expand the use of SDRs, cited by Stiglitz, is the legitimacy issue of fairness. Under a dollar reserve system, states must maintain sizeable dollar reserves to guard against capital outflows during financial crises. States need dollars to pay for imports, commodities and international loans, which are largely priced and settled in dollars. During a financial crisis, banks and the bond market may be unwilling to loan dollars, except at punitively high rates. States could turn to the IMF, but the loans are subject to pro-cyclical
conditions that would impose austerity, force drastic cuts in expenditure and prolong recessions. Rather than depending on the IMF or the market for dollars during an emergency, states learned the lesson after the 1997 East Asian financial crisis that they should hold large dollar reserves (Stiglitz 2010, 161–62). As a result, exporting states have accumulated nearly US $800,000m. of additional reserves a year, close to tripling their dollar reserves from 5.6% of world GDP before the East Asian crisis, to 13% of world GDP at the end of 2009 (Stiglitz 2010, 162).

Stiglitz argues that the dollar-dominated system is illegitimate and unfair because it forces countries to accumulate large dollar reserves instead of investing domestically. The dollar reserves are then lent to the USA, typically at very low interest rates. Adjusted for inflation, the return on US treasuries is negative (Stiglitz 2010, 163). The poorly paying loans amount to a transfer of resources—US $3,700,000m. worth in 2007—from poorer, developing surplus countries to wealthy deficit countries. The money that flows from the developing world allows the USA to spend nearly a trillion dollars a year more than it produces, and it fuels asset bubbles (such as in real estate and the stock market) that lead to financial crises. The unfairness is that developing country resources could have been invested domestically to finance economic growth and greater consumption for the poor, but instead they must be invested overseas in dollar assets to safeguard against capital flight. According to the UN Commission, the ‘transfer of resources to the reserve currency countries … exceeds in value the foreign assistance that developing countries receive from the developed countries’ (Stiglitz 2010, 163).

A reformed system might be fairer by giving developing countries greater access to a reserve asset—the SDR—that can be used as a source of emergency liquidity during a crisis. In an SDR-dominated system, countries would spend less on accumulating large dollar reserves and more on domestic investment, economic growth and human development. The result would be a more legitimate and equitable system.

(c) An institutionalist criticism of SDRs

While accepting the criticism that the dollar system may be unfair, unstable and lower growth, I would ask whether the SDR proposal is backed by sufficient institutions to succeed. On this ground, there is understandable scepticism about the near-term efficacy of SDRs from an institutionalist perspective.

One of the functions of an international reserve currency is to provide emergency liquidity in a financial crisis. The dollar has the twin advantages of (1) being backed by the Federal Reserve, which can act quickly in crises and (2) being freely usable, as it does not have to be converted into other currencies before being used in transactions with private parties. By contrast, it would be much slower to rely on SDRs (Eichengreen 2011, 145). Since SDRs are not freely usable in private transactions, foreign central banks would have to activate the voluntary arrangements of the IMF, waiting 5 to 10 business days before their SDR holdings could be converted to freely usable currency, like the dollar (IMF 2009a, 14). Given that central banks often have to act in hours when intervening in currency markets, a 5-to-10-day delay would be ‘an eternity in a crisis’ (Eichengreen 2011, 138). The damage to foreign currencies and businesses could be irreparable by that time. The IMF acknowledges the delay of converting SDRs when it writes: ‘with their use limited to the official sector, official SDR holdings provide an imperfect reserve asset, as they cannot be used directly for market intervention or liquidity provision’ (IMF 2011a, 4).

A second institutional problem is that there may be insufficient agreement among the IMF member states to allow the Fund to issue enough SDRs to make a meaningful change in the composition of the world’s reserve assets. Even if agreement could be reached on the amount of SDR allocations, their distribution could be more divisive. The question of who would get the
SDRs could be more controversial once the amount of SDRs greatly increases. Currently, they are distributed according to states’ IMF quotas, which are set according to the size and openness of economies. The criteria favour the rich countries receiving the most SDRs. If future allocations became much more sizeable and frequent, countries could be deadlocked over how SDRs should be divided (Eichengreen 2011, 141).

The difficulties of the euro

Given the problems of expanding the role of SDRs, it may seem that the most plausible rival to the dollar would be the euro. However, the euro is backed by insufficient institutions to challenge the dollar. These limits have become especially apparent with the recent European sovereign debt or eurozone crisis.

The crisis has led the institutions that back the euro, including the European Central Bank and European Commission, to demand that eurozone countries receiving bailout funds reduce their unsustainable debt burdens. These countries must cut their government spending and raise taxes, a policy known as ‘austerity’ or ‘fiscal consolidation’. The drawback of this policy is the timing of the cuts. During a recession, households and businesses are already reducing their spending. The only sector that can increase spending and support the economy is the government. If governments cut their spending too quickly, while their economies are still in recession, austerity policies can reduce economic growth even further. Lower economic growth can actually worsen the debt burden problems that austerity was meant to solve. While governments should cut spending over the medium to longer term once the recovery is underway, premature austerity can be counter-productive in reducing debt-to-GDP ratios.

Oliver Blanchard, the chief economist of the IMF, has found that the fiscal multiplier, which measures the impact of a change of government spending on national income, was three times higher than previously estimated. What this means is that cuts in government spending are contracting economies three times more than expected (Blanchard and Leigh, 2013). This exacerbates government debt problems in two ways. First, premature austerity directly worsens debt-to-GDP ratios by reducing GDP. Second, it can increase debt by raising the interest rates on sovereign bonds. Private investors, seeing slowing economic growth, can conclude that the government will receive less tax revenue and be less able to service its bonds. To compensate for the risk of lending to the government, the investors demand a higher interest rate, making government borrowing more expensive and further worsening the debt-to-GDP ratio.

The consequence of lower growth for the euro is that it can undermine the currency’s potential reserve status. One of the desirable features of a reserve currency, according to the instrumental view, is stability of value. But the stable value of the currency can be threatened with a rising debt-to-GDP ratio, caused by lower growth among other factors. Greater debt can raise concerns among private investors that the government will default or inflate away the value of the currency.

According to the institutionalist view, the institutions that issue a currency can help to promote economic growth, thus supporting the viability of the government’s debt and the currency’s stability of value. The problem with the euro is that it lacks the institutions possessed by the dollar to promote economic expansion. For instance, the ECB does not have a dual mandate to maximize employment and control inflation. It only has a single mandate to keep inflation low. Due to this single mandate, the ECB can hold interest rates excessively high, discouraging growth. For example, the ECB has raised interest rates twice in 2011, despite the high levels of unemployment in the eurozone (Ewing and Werdigier 2011, B8). Because of its single mandate, the ECB is also unable to engage in the kind of quantitative easing that the Federal Reserve pursues on a very large scale to stimulate the economy.
A further problem, from the institutionalist standpoint, is that the eurozone’s institutions have pressured countries to dismantle their automatic stabilizers (such as unemployment insurance) and not to engage in fiscal stimulus. The automatic and discretionary fiscal tools that the US government has used to counter its recession are not available to countries under the bailout terms imposed by the ECB, European Commission and International Monetary Fund.

Because of the problems with the SDR and the euro, it may seem that a remaining viable challenger to the dollar is the Chinese renminbi. Arvind Subramnian claims that the renminbi will replace the dollar as the dominant international reserve currency in 10 to 15 years (Subramnian 2012). The renminbi does have certain advantages over the euro from the institutionalist perspective. For instance, the Chinese government is able to use fiscal and monetary stimulus to promote economic growth, unlike the ECB. In 2012, China lowered interest rates twice and spent US $157,000m. on infrastructure projects to encourage growth (Reuters 2012).

However, for the renminbi to be a reserve currency, it would have to be readily available to private economic actors and governments to pay for their international transactions. They would need to be able to buy or invest in renminbi as easily as US treasury bonds. But the renminbi is not readily available due to China’s restrictions on capital flows. The renminbi is not a ‘fully convertible currency’ with an open capital account, or no government controls on the movement of financial capital in and out of the country. As a result, a mere 0.1% of international debt securities are denominated in renminbi (Prasad and Ye 2012). The renminbi cannot challenge the dollar, or even become a major reserve currency, while China maintains its capital controls.

Conclusion

In this chapter, I have offered an institutionalist approach that seeks to explain why currencies gain reserve status and have applied it to debates about the future of the dollar. The institutionalist approach argues that institutions can enhance a currency’s reserve status by supporting economic growth and by intervening quickly in financial crises. The institutionalist approach adds to the market, instrumental and geopolitical perspectives on reserve currency status. The instrumental and geopolitical perspectives examine the decisions of foreign governments that demand a currency. Governments demand a currency as a means of pursuing economic goals (the instrumental view) or to promote their security, power or military alliances (the geopolitical view). The market-based approach focuses not on governments, but on whether private actors support a currency, based on its liquidity and stability. By contrast, the institutionalist approach differs from the instrumental and geopolitical views, since it looks at the institutions, like the Federal Reserve, IMF or ECB that supply a currency. The institutionalist approach also differs from the market perspective, because institutionalism explains how the currency’s liquidity and stable value can be supported by institutions.

Consistent with the institutionalist approach that I develop, this chapter suggests that the IMF and ECB do not currently have the institutional powers to support SDRs or the euro sufficiently to challenge the dollar. The IMF faces key limits as an institution in providing SDR liquidity and acting as a lender of last resort. The ECB and the institutions of the eurozone more generally have worked to dismantle the automatic stabilizers and exclude the fiscal stimulus needed to promote economic growth and, with it, the sustainability of sovereign debts in the eurozone. An SDR-centred system may arguably be fairer and more legitimate than the dollar system. Poor developing countries would transfer less of their money to rich deficit countries like the USA. But, for the SDR or euro to pose a more effective challenge...
to the dollar, the institutions that support those currencies would have to be reformed to be capable of providing greater liquidity in the case of the IMF, and higher growth in the case of the ECB.

**Note**

1 Parts of this chapter have been adopted from the article Minh Ly, ‘Special Drawing Rights, the Dollar, and the Institutionalist Approach to Reserve Currency Status’, *Review of International Political Economy* 19, pp. 341–62, 2012. This chapter differs, however, in expanding the concept of the institutionalist approach to reserve currency status. Institutions can support the international reserve status of a currency not only by intervening as a lender of last resort, but also by promoting the economic growth needed for a currency to maintain its stable long-term value. A stable long-term value is one of the key determinants for private investors considering which currency to use for international transactions. Second, this chapter is also distinct in comparing the future of the dollar with the euro, in addition to special drawing rights (SDR).

**References**


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Part III

Governing development
The history of international development aid

David Williams

Introduction

The provision of aid to developing countries has become an increasingly important part of contemporary international relations. The number of aid donors has increased, and the total amount of aid given to developing countries has risen significantly, especially in the last 10 years. For many developing countries, relations with development agencies have become a central part of their international affairs, and, for some of the most aid-dependent states, foreign assistance has become central to their ability to provide services to their population. For Western states, the provision of development aid has become an important instrument for achieving international objectives including the cultivating of political allies, opening markets, fighting terrorism and constructing regimes of global governance. The provision of foreign aid has also been very controversial. There is an important (and very lively!) debate about how effective foreign aid has been in stimulating development and thus about whether donor countries ought to be more generous in their aid provision. In addition, over the last 10 years or so, there has been increasing pressure on Western donors to provide aid in a more effective, co-ordinated and transparent manner. For all of these reasons, foreign aid is an important site of investigation into changing practices of global economic governance.

Given the centrality of foreign aid to contemporary international politics, it is easy to forget that as an institutionalized activity it is a relatively recent phenomenon. While there are important precedents, the provision of foreign aid results largely from the newly dominant position of the USA at the end of World War II. Aid was seen as an important instrument in the foreign relations of the USA in the context of its broad ambition to create a relatively open and prosperous international economy and in the context of Cold War competition. While the USA remained the largest provider (in absolute terms) of foreign aid for most of the period since the war, the provision of development aid was institutionalized more generally with the creation of other bilateral and multilateral agencies. During the period after World War II, the developmental paradigms that shaped the provision of aid changed significantly as development agencies and academics responded to changing political and economic circumstances inside and outside developing countries.

This chapter explores these issues in turn and ends by reflecting on some of the challenges facing development agencies. Despite the quite considerable amounts of aid provided over the
years, there remain important questions about how successful it has been in stimulating and sustaining processes of development, especially in the world’s poorest countries. Moreover, the proliferation of aid donors has created problems of co-ordination and harmonization between donors, both within individual development countries and at the more general level, and donors have come under increasing pressure to provide aid in a more transparent and accountable way.

This chapter focuses mainly on the donors that make up the Organisation for Economic Co-operation and Development’s Development Assistance Committee (OECD DAC). It does not look in detail at ‘new’ aid donors such as China, nor does it consider the role of non-governmental organizations (NGOs) in development. Both of these important issues are covered in other chapters in this volume. The OECD defines Overseas Development Assistance (ODA) as flows to developing countries and contributions to multilateral agencies, provided by governments or government agencies, which have as their main objective the ‘promotion of the economic development and welfare of developing countries’ and that are ‘concessional in character’. This means that, for monies provided to count as ODA, there has to be something better about the terms than those available through commercial lending—this might be lower rates of interest or longer repayment times. This definition excludes military assistance, peacekeeping spending and assistance to refugees, even though these are important elements of the relationship between Western states and developing countries. This definition also excludes private financial flows to developing countries, although for many developing countries, especially middle-income ones, private financial flows have at times been very significant. Finally, aid encompasses more than just money and can include the provision of goods, technology and expertise.

The USA and the origins of international development aid

The origins of foreign aid as an institutionalized activity lie in the political and economic ambitions of the USA at the end of World War II. Some of the ideas and practices that made up this new form of activity go back a lot further. The idea that social and economic ‘progress’ was not only possible and desirable, but was one of the main objects of government policy, stretches back at least to the Enlightenment. The idea that there might be mutual gains from economic development, although contested, again goes back to the ideas of the great Enlightenment thinker, Adam Smith. The British Colonial Development Act of 1929 provided for monies to be spent on development projects in British colonies (Little and Clifford 1965, 341–42). A more immediate precedent was the ‘good neighbor policy’ instituted by President Roosevelt in the late 1930s, during which the USA began to provide development loans to Latin American countries through the US Export-Import Bank (Helleiner 2006).

It was in the period after the end of World War II, however, that international development aid became a key part of US foreign relations. The USA ended the war in a dominant economic and military position, and it used this to construct an international order that preserved and enhanced its own economic and security interests (Layne 2006, Ch. 2). In 1945 President Roosevelt said that ‘there can be no middle ground here. We shall have to take responsibility for world collaboration or we shall have to take responsibility for another world conflict’ (quoted in Burley 1993, 130). Within this broad ambition, assisting developing countries through the provision of foreign aid had two different, although related, objectives.

The first was to assist in the development of a vibrant post-war international economy. One of the key features of the US post-war order was a commitment to characteristically liberal views about the mutual benefits that derived from economic development and a relatively open
and stable international trading regime (Ruggie 1982). This was evident in Truman’s ‘Four Point’ speech delivered at his inauguration in 1949:

We must embark on a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas. More than half the people in the world are living in conditions approaching misery … Their poverty is a handicap and a threat both to them and to more prosperous areas. All countries, including our own, will greatly benefit from a constructive program for the better use of the world’s human and natural resources.

This was also evident in the creation of the International Bank for Reconstruction and Development (IBRD, now the World Bank) at the Bretton Woods Conference in 1944. US planners thought that the provision of development aid through the Bank would benefit the USA because economic development would provide export markets for US products, and because they thought that economic prosperity and stability would lead to political stability and hence improved security for the USA. Developing countries were also supportive of the Bretton Woods Agreement because they saw it as providing assistance and support for their own economic development (Helleiner 2006).

The provision of foreign aid was also driven by the emergence of Cold War competition. This can be seen as early as 1947, when Truman articulated what became known as the ‘Truman Doctrine’ in a speech before a joint session of the US Congress on 12 March. The backdrop to the Truman Doctrine was an economic crisis that gripped Europe during the winter of 1946–47. In the context of increasing tension between the USA and the USSR, American policymakers became concerned that this crisis would present political opportunities to the already strong communist movements in many European states. The Truman Administration stepped in and provided military and economic assistance to both Greece and Turkey, and provided extensive economic assistance to other European countries through the Marshall Plan. Truman’s 1947 speech can be seen as the clearest articulation that the USA would use its financial and military assistance in the context of Cold War rivalry:

One of the primary objectives of the foreign policy of the United States is the creation of conditions in which we and other nations will be able to work out a way of life free from coercion … I believe that our help should be primarily through economic and financial aid which is essential to economic stability and orderly political processes … If we falter in our leadership, we may endanger the peace of the world—and we shall surely endanger the welfare of our own nation.

In other words, foreign aid would be used explicitly in the fight against communism. Other countries followed the USA in developing a foreign aid programme, but there is little doubt that the USA was the first state to make the provision of aid a regularized part of its foreign relations as an instrument for achieving both its broad economic and international goals and the narrower goal of containing communism.

The development of the US aid programme

Both of these kinds of rationales for the provision of foreign aid can be seen in the development of the USA aid programme through the Cold War. US foreign aid to non-European countries really got going with the 1950 Act for International Development (McGuire 1962; Amuzegar
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1958). The then Secretary of State, Dean Acheson, said that the Act was a ‘security measure’ as the USA’s ‘military and economic security is vitally dependent on the economic security of other people’ (quoted in McGuire 1952, 343). In 1954, the International Cooperation Administration (ICA) was established to administer foreign aid and technical assistance programmes. In the same year the Food for Peace programme (sometimes called the 480 programme) was established to channel food aid to developing countries (Frank and Baird 1975, 142). In 1957, the Development Loan Fund (DLF) was established to provide loans on more concessional terms to the poorest developing countries. By the second half of the 1950s the ICA had established field offices in 60 countries and employed over 4,000 staff (Cleveland 1959, 219–21). The 1961 Foreign Assistance Act created a unified agency—USAID—that drew together the ICA, the DLF, and the Food for Peace programme. The new agency also started to develop new methods for distributing its aid. Of particular importance was the country programming process, whereby US aid would be conditional on the recipient country having an economic development plan. This contrasted with the previous method of ad hoc funding of individual projects (Lancaster 2007, 72). The amount of aid given also increased in the first half of the 1960s—particularly to Latin America and increasingly to sub-Saharan Africa, both in absolute terms and as a percentage of gross national product (GNP). Although the containment of communism was an important element of the renewed stress on development assistance, it was also clear that the broader objective of economic development was being taken more seriously.

US aid began to rise significantly in the later 1970s and continued to rise through the first half of the 1980s for reasons that reflected both the political and developmental purposes of aid. The attempt by the Ford Administration to encourage a peace settlement between Israel and Egypt led to a significant rise in aid to both countries, such that they became the two largest single aid recipients by 1976. The USA was also providing aid to a number of other states for fairly obvious political/Cold War reasons (Turkey—key NATO ally, Philippines—US military bases, Nicaragua—to combat left-wing insurgency). But the USA was also providing aid to a variety of countries, particularly in Africa, where there were no especially compelling political interests—for example, Mali, Benin, Burkina Faso (Lancaster 2007, 79). In addition, as a result of famine in Ethiopia and floods in Bangladesh, emergency aid and food aid rose sharply (Lancaster 2007, 178). Despite the initial scepticism of the Reagan Administration towards foreign aid, much the same continued through the 1980s. Aid to Latin America increased for Cold War reasons, but so did aid to Africa. Total US aid to Central and South America rose from US $280m. in 1980 to $1,175m. in 1985, while aid to Africa rose from $1.507m. to $2.860m. By 1989 US bilateral aid was 30% higher than it had been in 1980 (Lancaster 2007, 83). President Reagan neatly summarized all this in 1985: ‘in helping our allies and friends meet their security, development and humanitarian needs, we directly support US interests and objectives. Our foreign assistance programs, despite any perceptions to the contrary, are manifestly in our own national interest’ (White House 1985).

The period after the end of the Cold War was a turbulent one for US development aid, in part because of renewed domestic criticism of the US foreign aid programme. Nonetheless, by the mid-2000s US aid had nearly doubled from its level in 1989. Assistance to the states of Central and Eastern Europe (and then the states of the former Soviet Union) to aid their political and economic ‘transition’ to liberal economic and political systems became an important new component of US aid. Total aid to these state rose to over US $2,500m. in 1994 (Lancaster 2007, 84; Carothers 1999, 50). Democracy promotion also became a more significant part of the US aid programme. Total democracy assistance aid rose from $165m. in 1991 to $435m. in 1995, and aid for democracy in sub-Saharan Africa tripled over the same period (Carothers 1999, 50–52). Another set of concerns for US aid came in the area of civil wars
and peace building, and the USA provided aid to numerous post-conflict states including of course in the Balkans, but also Haiti, Sierra Leone, Liberia, Colombia and Angola (Lancaster 2007, 85).

The new Bush Administration oversaw a dramatic increase in US aid. Part of this is explained by significant amounts of aid given to Afghanistan and Iraq (and Pakistan), but there are other factors at work. First, in the aftermath of 11 September 2001, there was a reorientation of US national security strategy towards seeing developing countries as a source of ‘threats’ to the USA, and thus a renewed emphasis on aid as a mechanism to combat these (White House 2002). Second, there was a renewed stress on the developmental aspects of US aid provision, notably through the Millennium Challenge Account (MCA), announced in March 2001 (Radelet 2003a; 2003b). This provided a significant amount of money to a select group of low-income states that were ‘ruling justly, investing in their people and establishing economic freedom’ (quoted in Radelet 2003b, 171). The MCA involved 16 specific indicators including controlling corruption, respect for political rights, primary education spending, inflation and trade policy. It is probably the most important innovation in US aid provision since the creation of USAID, and it is important to note that it is exactly developmental in purpose and targeted at poorer states. Finally, there was a marked increase in aid specifically directed at HIV/AIDS prevention and treatment.

In 2004 USAID produced a policy paper that summarized the objectives of US aid policy (USAID 2004). It announced that the goal of US aid was not simply raising living standards, but ‘transformational development’: ‘Far-reaching, fundamental changes in institutions of governance, human capacity, and economic structure that enable a country to sustain further economic and social progress without depending on aid’. The paper also identified four specific goals for US aid: strengthening fragile states, responding to humanitarian crises, supporting US strategic interests and managing global problems. There is clear continuity here with the place of development within the hegemonic ambitions of the USA after World War II, and it demonstrates the continued significance of foreign aid for achieving international objectives.
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The institutionalization of foreign aid

The provision of foreign aid was institutionalized more widely in international politics from the 1950s onwards. Many states developed their own bilateral aid programmes, partly in response to the emergence of US aid and partly because they too found that foreign aid could be a useful instrument for achieving international objectives. In addition, a number of new multilateral agencies were created.

Bilateral aid

The USSR developed its own aid programme from the mid-1950s in response to the growth of US aid and as part of a desire to assist countries in a transition to socialism (Guan-Fu 1983). While there are some parallels between Soviet and US aid (it was used by both to cultivate allies), there are also some differences. For one thing it was a lot smaller—for most of the period the Soviet aid programme was only about one-quarter the size of that of the USA. Soviet aid also tended to be much more ad hoc and volatile—for example, falling to almost nothing in the early 1960s (Guan-Fu 1983, 75). Finally, Soviet aid was never really ‘professionalized’ in the way that it was in the USA. There was no permanent development agency like USAID, rather a number of different bureaucratic entities were responsible for foreign aid. China has become a very significant provider of aid in recent years, but as early as the 1950s it too had a small but significant aid programme, animated by a desire to influence newly independent states, and as a mechanism for competing with the USSR for influence in the developing world (Poole 1966).

In terms of size, the bilateral aid programmes of the Western donors such as Britain, France and Japan were more significant. For Britain and France, large portions of their aid went to former colonies. Even by the mid-1980s, 70% of British aid went to Commonwealth countries, and nearly 90% of French aid went to its former colonies, especially in sub-Saharan Africa (Killick 2005, 65; Lancaster 2007, 147). Despite the aid programmes of Britain and France being in this sense similar, they diverged quite significantly from the 1990s onwards. In 1997 the new Labour Government in Britain created a new ministry, the Department for International Development (DfID), that significantly increased the profile of aid and development issues within government and oversaw a dramatic increase in total aid provision (Young 2001). DfID also modernized Britain’s aid policy by developing a professional research capability and publishing influential policy reports (Morrissey 2002; see also DfID 1997, 2000). DfID’s increased role was also related to British participation in larger international projects such as Kosovo, Afghanistan and Iraq. The situation in France was rather different. The 1990s was a period of crisis in French aid. This was related precisely to the close relationships that France had tried to maintain with her colonies. Many of these colonies in sub-Saharan Africa were experiencing sustained economic crises and, as France was by far the largest aid donor to most of them, this increased the pressure on the French aid budget in the context of attempts to cut the French government deficit in preparation for European monetary union (see Cumming 1995 and Renou 2002). There was also a growing public perception inside France that French aid was being used to prop up African dictators and enrich elements of the French political and economic elite—a perception heightened by a series of corruption scandals involving French companies in Africa (Lancaster 2007, 157).

Japan is probably the most interesting bilateral donor. Its aid programme was initially heavily concentrated on states in the region and driven significantly by commercial considerations. Japanese aid went particularly to finance projects in the energy and mining sectors as a way for Japan to gain access to resources (Lancaster 2007, 115; Yasutomo 1989, 492). A number of
factors in the mid-1970s led Japan to reconsider the size, scope and practices of its aid programme. The Japanese economy had grown rapidly and, as its exports had grown, there was a less urgent need to use foreign aid to expand export markets in the region. The fact that the economy had done so well also led the USA to pressure Japan to share more of the burden of managing global affairs. Finally, there were some sharp criticisms of Japanese aid both from recipient countries and from other Western donors about the excessively commercial, rather than developmental, elements of Japanese aid (Yasutomo 1989, 492–93). In 1977 Japan announced its intention to double its bilateral aid provision. To be sure, some of the largest recipients of Japanese aid during the first half of the 1980s remained states in the region—for example, Indonesia, Thailand and Burma—but by the late 1980s Japan had also become the single largest aid donor to a number of African states (Lancaster 2007, 119). All through the 1990s, Japan was the largest aid donor in dollar terms. This position was the result of the reduction in US aid provision and a deliberate strategy to become an ‘aid superpower’ (Yasutomo 1989; Lancaster 2007, Ch. 4). Japan’s aid budget doubled through the second half of the 1980s and continued to rise rapidly through the first half of the 1990s. In the second half of the 1990s and into the 2000s, however, Japan’s aid budget declined as a result of ongoing financial and economic crisis.

Many other countries developed bilateral aid programmes, such that we can consider the provision of development assistance to have become a ‘norm’ in international politics (see Table 16.1).

### Multilateral aid

At the same time as bilateral aid was becoming a regularized part of international politics, a number of multilateral development agencies were created. In terms of total aid provision and influence, the most important was the World Bank (IBRD, originally). The World Bank differed from the emerging bilateral development agencies in that it was established as a particular kind of bank. First, it was founded to provide loans for discrete development projects, rather than to provide general budgetary support to governments (although from the 1970s onwards it did provide this kind of support). Second, the World Bank was expected to raise investment capital through the sale of its own securities (bonds) in the financial markets and, although these were to be guaranteed by the member governments, the Bank was nonetheless established as a

### Table 16.1 Top 10 OECD DAC donors, 2011

<table>
<thead>
<tr>
<th></th>
<th>Total ODA, US $m.</th>
<th>ODD as % of gross national income (GNI)</th>
<th>Total to least developed countries, US $m.</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>30,924</td>
<td>0.20</td>
<td>9,623</td>
</tr>
<tr>
<td>Germany</td>
<td>14,093</td>
<td>0.39</td>
<td>1,873</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>13,882</td>
<td>0.56</td>
<td>2,965</td>
</tr>
<tr>
<td>France</td>
<td>12,997</td>
<td>0.46</td>
<td>2,048</td>
</tr>
<tr>
<td>Japan</td>
<td>10,831</td>
<td>0.18</td>
<td>3,420</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6,344</td>
<td>0.75</td>
<td>1,065</td>
</tr>
<tr>
<td>Sweden</td>
<td>5,603</td>
<td>1.02</td>
<td>1,013</td>
</tr>
<tr>
<td>Canada</td>
<td>5,457</td>
<td>0.32</td>
<td>1,536</td>
</tr>
<tr>
<td>Australia</td>
<td>4,983</td>
<td>0.34</td>
<td>1,020</td>
</tr>
<tr>
<td>Norway</td>
<td>4,939</td>
<td>1.00</td>
<td>1,003</td>
</tr>
</tbody>
</table>

Source: OECD

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A financial institution with obligations to those who purchased its bonds. This limited both the potential number of borrowers and the potential number of projects that the Bank could finance. Calls for the provision of financing to developing countries on more liberal terms started in earnest in the 1950s and led to the creation of the International Development Association (IDA) in 1960 in the USA (Mason and Asher 1972, 385). The World Bank also differed from bilateral aid agencies in that it was founded on the principle that it would be ‘non-political’.

Article III(5)(b) of the World Bank’s Articles of Agreement states that loans shall be granted with ‘due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations’. However, this supposed non-political stance was in tension with the formal power that member states exercised through the system of weighted voting on the Board of Directors. In general, the amount of votes a country has on the Board is determined by the amount of capital that countries pay into the Bank. The Board is charged with the day-to-day running of the Bank and approves all loans, policies and Bank reports. This gives developed states considerable power. There are also more ‘informal’ mechanisms for the USA to exercise influence (Gwin 1997). More generally, however, the USA does not explicitly exercise the power it has over the Bank because it does not have to: the Bank promotes the broad goals of US policy simply though its day-to-day operations—as it was designed to do. There is no doubt that the World Bank has been by far the most influential development agency. Some of this has to do with the amounts of aid it distributes, but it also has to do with its research capability, the long-standing relationships it has developed with recipient states and close ties with the US government.

The Bank has dramatically expanded the scope of its operations. In the years until the 1970s the bulk of its lending was for infrastructure projects (Mason and Asher 1972). Under the presidency of Robert McNamara, the Bank expanded its aid provision, but also began lending in new areas such as agricultural development, health and education. The expansion of the Bank’s areas of concern continued through the 1980s and 1990s, with issues such as good governance,
corruption, environmental protection, institutional development and participation. As the official history of the World Bank published in 1997 pointed out, the Bank’s problem by the middle of the 1990s was that its list of policy priorities had been stretched almost beyond recognition (Kapur et al. 1997). The Bank has also faced extensive criticism from a variety of sources for, among other things, its environmental record, its record in dealing with persons displaced by projects that it has funded and its lack of accountability (Rich 1994; Nelson 2001; Udall 1997). The Bank has tried to respond to these issues up to a point and, while it is still the subject of much criticism, it is probably also the most open and self-critical of all development agencies.

The World Bank was the only multilateral development agency until 1959 when the first regional development bank, the Inter-American Development Bank (IADB), was founded. This was followed by the establishment of the African Development Bank (AfDB) in 1964 and the Asian Development Bank (AsDB) in 1966. These are the most important regional multilateral development agencies, although there are a number of others. The Inter-American Development Bank was created alongside the Organization of American States (Tussie 1995). Although Latin American states had a significant presence at the Bretton Woods conference, they felt increasingly neglected by the World Bank as it turned its attention to newly decolonized states (Krasner 1981, 305; Tussie 1995, 18). The IADB enshrined but also limited US power. The IADB was overwhelmingly reliant on US capital for its operations, and there was a degree of proportionality in voting rights at the IADB (proportional on provision of capital) that gave the USA over one-third of votes and thus provided it with an effective veto over amendments to the Articles of Agreement (Tussie 1995, 18). On the other hand, the extent of proportional voting was limited by the stipulation that at least 50% of voting rights lay with the borrowing members, so that at least in principle the bank remained under the control of the Latin American states.

The AfDB was different from other regional development banks in that it was originally established without the participation of developing countries (English and Mule 1996). This had the fairly obvious implication that it was relatively poorly resourced. In the years after its founding the AfDB found it difficult to raise money on the international financial markets, and member states did not fulfill their obligations to provide money to the organization (it was not until 2003 that the AfDB received an AAA rating from bond-rating agencies). The financial problems came to a head when the AfDB wished to create a soft loan arm. Developed states were invited to participate in what became known as the African Development Fund in 1973. The structures put in place to govern this entity are in some respects extraordinary as there was a tremendous imbalance between financial contributions and voting rights (Krasner 1981, 324). Despite providing the overwhelming majority of the funds, developed states had less than 50% of the voting rights, thus preserving the control of African states. In 1982, developed states were allowed to participate in the AfDB itself—thus providing a much needed boost to its capital, but again only on the proviso that its African member states retained a majority of voting rights. Thus, the AfDB had significant autonomy from developed states, and remained a largely African Bank with the President and majority of its staff being from the continent.

The Japanese had been pushing for the creation of a regional development organization since the early 1960s (Wan 1995, 511). Japan felt that its own economic and political interests in the region were not well served by the World Bank and, as it was emerging from the immediate post-war period it wanted to exert more influence in the region (Kappagoda 1995). The USA was keen to establish a regional institution to support its increasing involvement in the region (Krasner 1981, 317). As a result of this, the AsBD was different from the IADB and the AfDB in that right from the beginning it had a strong presence of developed
countries—notably Japan and the USA, but also Australia and New Zealand, and, unlike the IADB and AfDB, developing country members never had a majority of the voting rights. Japan is the most influential state in the AsDB (Wan 1995). In 1974 a soft loan arm of the Bank was established—the Asian Development Fund—to which Japan contributed nearly half the capital. By tradition the President of the Bank is Japanese and the Japanese government collaborates closely with the Bank. In the early years of the bank’s operations, the bank served Japan’s economic interests well (Krasner 1981, 319; Wan 1995, 415). By the late 1970s and into the early 1980s, however, the obvious connection between bank lending and Japanese economic interests started to decline, even as its share of financial contributions to the organization rose. More loans went to countries where Japan had no significant economic interests (such as Bangladesh and Pakistan), and Japan’s share of procurements also fell (Wan 1995, 517–18).

As we have seen, foreign aid has been given for a complex set of reasons (Morgenthau 1962; Lancaster 2007). Some was certainly given for the purposes of maintaining political allies, but even here there have been differences between states: France and Britain, for example, have been concerned with maintaining relationships with former colonies, while the USA and Britain have both used aid as an important part of larger international projects. Some aid was also given more for commercial reasons, especially by France and Japan, for example. For many states, domestic politics has at various times been important in determining aid provision (Noel and Therien 1995). It is important not to be too cynical about the provision of development aid. The fact that over time it has continued to rise, and the fact that an increasing amount of it has gone to the world’s poorest states, particularly in Africa, suggest that states and development agencies have had a genuine commitment to the broader project of development, even if that too is understood to be in some broad sense in the interests of aid-giving states.

### Changing development paradigms

Since the provision of international development was institutionalized in international politics, the theories and arguments that shaped the funding of projects and programmes have changed quite significantly. In the years up to the early 1970s development policy was shaped by the development of a specifically ‘development economics’ and by ‘modernization theory’ (Williams 2011, Ch. 2). Modernization theory was concerned with political and social ‘modernization’, understood as the institutionalization of democratic government and the emergence of ‘modern’ social and cultural attitudes (Almond and Powell 1965; Almond and Verba 1965; Inkeles 1969, 1975). Development economics was concerned with outlining the economic policies that would lead to industrialization and sustained economic growth (Lewis 1954; Hirschman 1958). Both theories thought that ‘development’ involved processes of modernization similar to that of

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**Table 16.2 Multilateral development agencies**

<table>
<thead>
<tr>
<th></th>
<th>2011 total flows, US $m.</th>
<th>Voting power of USA, %</th>
<th>Voting power of developing country members, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Bank</td>
<td>27,674</td>
<td>16.5</td>
<td>47.2</td>
</tr>
<tr>
<td>IADB</td>
<td>9,879</td>
<td>30.0</td>
<td>50.2</td>
</tr>
<tr>
<td>AsDB</td>
<td>7,566</td>
<td>12.8</td>
<td>45.0</td>
</tr>
<tr>
<td>AfDB</td>
<td>5,406</td>
<td>6.4</td>
<td>60.4</td>
</tr>
</tbody>
</table>

Source: OECD

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David Williams
the developed West (industrialization, urbanization), and both groups thought that foreign aid could assist countries in that process. Finally, both theories (for rather different reasons) assumed that the state would play a significant role in driving the process of development, usually through active intervention in the operation of markets to provide the appropriate conditions for domestic development. In terms of development practice the primary outcome of these bodies of thought was a significant stress on infrastructure (dams, roads, ports, railways, electricity generation projects) and industrialization.

During the 1970s a different set of arguments about ‘basic needs’ and ‘redistribution with growth’ came to the fore (Streeten 1981; Chenery et al. 1974). In 1973, then President of the World Bank, Robert McNamara, said that ‘the basic problem of poverty and growth in the developing world can be stated very simply. The growth is not equitably reaching the poor. And the poor are not significantly contributing to growth’ (McNamara 1973). Associated with this was a new concern with improving agriculture (the majority of the poor lived in rural areas), health services and education, and a downplaying of the role of large capital projects as the key determinants of development. This way of thinking about development was short lived as a series of economic and political crises engulfed many developing countries, and the ‘golden age’ of capitalism came to an end (Glynn et al. 1990). In this context a new set of ideas came to the fore, sometimes captured under the label of the ‘Washington consensus’ (Williamson 1990). In economic terms this meant the liberalization of markets, both internally, especially in agriculture, and externally in terms of trade and capital flows. As a corollary of this, it meant reducing the role of the state in the economy (and thereby reducing the possibilities for rent-seeking and corruption) (Lal 1983). In terms of development policy the most important and controversial product of this was structural adjustment lending. This was the use of conditional lending by the World Bank and IMF to encourage developing countries to enact market-friendly reform programmes (for a summary and assessment see Mosley et al. 1991). Structural adjustment lending was in fact not especially successful, either in inducing policy reform or stimulating economic development, and through the later 1980s and into the 1990s what is sometimes called the ‘post-Washington consensus’ emerged, led in large part by the World Bank. This maintained the stress on the importance of allowing the market to allocate economic resources (rather than the state) but recognized that a vibrant market economy required a series of effective institutions to work at all properly, and an effective but not overbearing state to monitor and regulate it (Williams 2008a). This led to an emphasis on such things as legal reform, banking regulation and reducing corruption on the one hand, and good governance, decentralization and, sometimes, democracy promotion on the other.

By the late 1990s and up to the financial crisis of 2007–08 these arguments gained added significance in two ways. First, governance reforms and economic liberalization were seen as the key route for developing countries to tap into increasingly globalized patterns of trade and finance (DfID 2000; for an assessment see Rodrik 2001). Second, governance reforms in developing countries were seen as an important part of the construction and expansion of regimes of global governance. In the wake of the Asian Financial Crisis and 11 September, for example, development agencies have taken a leading role in reforming banking and financial regulation in developing countries in order to prevent poorly regulated financial systems from posing a more general threat to Western interests (Williams 2008b).

Alongside this, two other new policy concerns should be mentioned. First, a new language of ‘participation’, ‘ownership’ and ‘partnership’ emerged. At the country level this new concern manifested itself most significantly in the Poverty Reduction Strategy Paper (PRSP) process initiated by the World Bank and the IMF in 1999 (Craig and Porter 2003). The idea behind this was that governments would develop a poverty reduction strategy in consultation with civil
society groups. Second, a more explicit concern with poverty alleviation found expression in the United Nations Millennium Development Goals (MDGs). These were a series of development targets established in 2000, which included such things as: halving the proportion of people living in absolute poverty (defined as having less than one dollar a day); ensuring universal primary education; reducing child mortality rates by two-thirds; reducing maternal mortality by three-quarters; and halving the proportion of people without access to clean drinking water. What makes the MDGs remarkable is not so much their content as the fact that there was an immediate political consensus among almost all states and development agencies as to the desirability of these goals (Fukado-Parr 2004).

The contemporary situation is a complex one. The recent financial and economic crisis has undermined the legitimacy of the stress on liberalization and integration into the global economy in the eyes of many developing countries. In addition, the experience of China has led to a renewed stress on infrastructure and industrial development as the keys to development success. On the other hand, the achievement of the MDGs remains at least officially a guiding principle of all Western aid donors, and good governance and democracy remain key aims of Western aid provision.

Challenges

One of the great questions surrounding the provision of development aid is whether it ‘works’ to promote economic development, and the answer has very important implications for contemporary arguments about whether developing countries need more foreign aid. Jeffrey Sachs, for example, has called for a large increase in aid as a way to overcome the ‘poverty trap’ that characterizes the world’s poorest states. In this view, foreign aid can play an important role in stimulating economic development (Sachs 2005). Others have been much more sceptical. William Easterly, for example, has made some very pointed criticisms of Western aid and has argued that there is little evidence that a substantial increase in foreign aid would make much difference to the development of the poorest states (Easterly 2005, 2006). Dambisa Moyo has gone even further and argued that foreign aid to Africa has often done more harm than good, and she argues that African states need to find a way to wean themselves off aid if they are to be successful (Moyo 2009).

One of the difficulties of coming to any conclusion about this is that assessing the impact of aid is difficult. One problem is that ‘works’ might mean different things: it could mean that a particular project or programme achieved its stated objectives, or it could be understood in terms of impact on broader developmental or macroeconomic objectives, such as economic growth or poverty reduction. In terms of individual projects and programmes, Roger Riddell has concluded that, for most donors, project success rates range from 70%–85% and that on balance success rates have improved compared to 1965–85 (Riddell 2007, 180). These aggregate figures mask significant variations in success rates between countries and across sectors. The World Bank had most success in East Asia and the Pacific (nearly 90% of projects judged as successful) and the least in sub-Saharan Africa (70%). In terms of sectors, the World Bank rated its projects in transport, rural development and finance at 85% and the environment at less than 70% (World Bank 2005). The Asian Development Bank rated transport and energy as its best performing sectors (85%), but financial and agricultural sectors as its worst performing (50%). The African Development Bank rated 75% of its agricultural development projects as successful, but only 46% of its financial sector projects (Riddell 2007, 182–83). In 1995 the World Bank produced a major evaluation of its structural adjustment lending. It reviewed the experiences and outcomes of 99 adjustment programmes in 42 countries, mostly from the mid-1980s...
onwards. Of the 88 operations given a rating, 32 were rated as ‘unsatisfactory’ (Jayarajah and Branson 1995, 276–79).

Even if individual projects and programmes are more successful than not, this may have rather little impact on broader macroeconomic or developmental variables, which tend to be determined by a complex set of factors and relationships, both internal and external (Kenny and Williams 2001). Developmental outcomes are shaped by a host of factors (changing terms of trade, oil price rises, fiscal crises, political instability) and can improve even with a host of ‘bad’ projects and programmes. Teasing out the impact of aid is then very tricky and is compounded by questions about the quality of the macroeconomic and socio-economic data available in many developing countries, especially the world’s poorest (Riddell 2007, 166–67). What evidence there is suggests that inflows of foreign aid may not have much positive impact on broad development indicators (Easterly 2005). Lancaster has concluded that ‘most of the econometric studies of the relationship of aid to growth have found that aid has no significant impact, either positive or negative on economic performance’ (Lancaster 1999, 44). This is not to say that aid does not do important and valuable things; but it does suggest that the contribution of aid to broad developmental variables might be relatively slight.

Even more unsettling for advocates of foreign aid are those arguments that suggest it may have a negative effect on developing countries. Moyo argues that it promotes corruption and dependency, with significant consequences for development and democracy (Moyo 2009, 49). More specifically, it has long been argued that the lack of co–ordination between development agencies creates many problems for aid recipients (Cassen 1986, Ch. 7). Especially in the world’s poorest states there may be as many as 30 official aid agencies operating, and possibly hundreds of development NGOs. In these circumstances, and especially given the relatively weak capacity of recipient governments (and a desire on the part of some donors to bypass the government), serious problems of co–ordination have arisen. Often little thought was given to how individual projects fitted into an overall development strategy or to how recurrent costs would be financed, and donors often funded similar projects, leading to overlap and redundancy. In addition, different donors placed different demands on recipient governments in terms of accounting, auditing and procurement.

In recent years there has at least been some recognition of the need to deal with these problems. The 2005 Paris Declaration on Aid Effectiveness was an international agreement on the part of Western donors and developing country governments to develop country ‘ownership’ of development strategies, to harmonize donors’ policies and to encourage mutual accountability (OECD 2005). Subsequently meetings have been held in Accra in 2008 and Busan in 2011 to assess progress towards these goals. While the commitment to making foreign aid provisions more effective is laudable, progress to date on actually implementing new practices has been slow. A 2011 OECD report on the implementation of the Paris Declaration suggests that only one of the 13 targets set has been achieved (OECD 2011).

Western donors have been criticized for other failings, too (Birdsall 2005). It has often been argued that they have not paid enough attention to building indigenous institutional capacity, and thus not really laid the foundation for sustainable development. In many cases donors have simply bypassed existing government departments in order to implement their projects quickly. It has also been argued that they are often not thorough enough in evaluations of their own projects and programmes, that they do not withdraw from failing projects and that the assistance they do provide is often volatile and unpredictable. Donors are also coming under much more pressure from the growing aid transparency movement. For example, the International Aid Transparency Initiative argues that donors should disclose regular, detailed and timely information on volume, allocation and results of development expenditure (when available); make
public all conditions linked to disbursements; provide full and timely information on annual commitments and actual disbursements; and provide developing countries with regular and timely information on their rolling three-to-five-year forward expenditures and/or implementation plans (IATI 2012). The fact that many donors do not currently do this suggests that quite serious problems remain with the relationships that they have with many developing countries.

**Conclusion**

The provision of foreign aid has expanded and changed considerably. It originated as a result of the very powerful position of the USA at the end of World War II. Subsequently, many other countries adopted the practice of aid-giving, multilateral development agencies were created, and the amount of aid provided to developing countries has increased substantially. Foreign aid has been provided for a number of different reasons. While it would be wrong to deny the genuinely developmental purpose of some aid, much of it has also been used for political and security purposes, and in more recent times as a mechanism for creating regimes of global governance and combating terrorism. The developmental rationale for foreign aid has also changed, from a stress on infrastructure, to poverty alleviation, to economic liberalization, to good governance and democracy, and now to participation and poverty reduction (again!). It will almost certainly change again.

While the developmental record of foreign aid has always been questionable it is certainly the case that in recent years it has come under a greater deal more scrutiny. Serious questions have been asked about its effectiveness and about the way in which donor practices create a host of problems for recipient countries. Coming to any final conclusion about the impact (positive and negative) of foreign aid is hard, in part because it is quite hard to measure. It does seem safe to say, however, that it has been decidedly mixed. Despite all the criticisms of foreign aid, there is no reason to think that it will disappear any time soon. Western states see it as an important instrument for the achievement of varied international objectives, including ‘development’, and many developing countries, for good or ill, have become reliant on it. Foreign aid is likely to remain a central part of international politics and international economic governance, warts and all, for many years to come.

**Notes**

1 There are 24 members of the OECD DAC: all the major Western donors plus the European Union (EU).
2 These include the East African Development Bank (1967), the Caribbean Development Bank (1970), the Andean Development Corporation (1970) and the Islamic Development Bank (1975). In the post-Cold War era these are joined by the European Bank for Reconstruction and Development (1991) and the North American Development Bank (1993).
3 See, for example: Publishwhatyoufund.org; makeaidtransparent.org; and aidtransparency.net.

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David Williams

The World Bank in the post-structural adjustment era

Matthew S. Winters and Shyam Kulkarni

Originally created as part of a global financial architecture aimed at reducing the likelihood of global economic crisis and now situated as the preeminent institution in the broad international development community, the World Bank has witnessed tremendous transformation of its mission, structure and operations over its 65-year existence. In this chapter, we focus on the World Bank as a lender of international development funds. We first briefly describe some of the major transformations that the Bank underwent through the mid-1990s in order to set up an extended discussion of the incorporation of the ‘governance and anticorruption’ (GAC) agenda into the World Bank’s lending operations. We show how the GAC agenda emerged as the product of crises of legitimacy and effectiveness linked to the failures of structural adjustment lending during the 1980s and early 1990s. We argue that the GAC agenda remains ill defined almost 20 years after its emergence, for three fundamental reasons: (1) the challenges of creating better governing institutions in the developing world; (2) the disbursement culture that drives bureaucratic decisions within the Bank; and (3) the question of to which constituencies the Bank should be responsive.

These underlying issues are likely to colour any future transformation of lending operations that the World Bank attempts to undertake. We conclude the chapter by showing how these concerns have affected the design and are likely to affect the implementation of the Bank’s newest lending innovation, Program-for-Results (P4R) financing, introduced in 2012.

The ever-changing World Bank

From the earliest days of its existence, the World Bank has been responding to crises of legitimacy, effectiveness and relevance. In this section, we describe an early legitimacy crisis related to the fundamental question of to which constituency the Bank should be responsive and suggest that the answer to the question remains generally unresolved. Then we show how a crisis of relevance introduced major changes in the Bank’s lending operations in the 1960s and 1970s, creating the disbursement culture that underlies more recent crises of legitimacy and effectiveness.

The original arm of the World Bank, the International Bank for Reconstruction and Development (IBRD), was created at the Bretton Woods Conference of 1944 as part of the
ensemble of institutions meant to prevent another global economic crisis like that of the 1930s. As spelled out in the first section of its Articles of Agreement, the purpose of the Bank was

[to assist in the reconstruction and development of territories of members, … including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.

(IBRD 2012, Articles, Art. 1)

In its earliest days, the Bank faced two crises in rapid succession: one of legitimacy and one of relevance. The crisis of legitimacy was an early manifestation of one of the World Bank’s key problems, the question of to whom the Bank is responsible. This crisis took the form of a debate over who would actually run the Bank: the country-appointed executive directors or the management staff. This issue led to the resignation of the first president and was only settled when his successor made administrative authority a precondition for his taking the position (Mason and Asher 1973, 46–50; Kapur et al. 1997; Kapur 2002). The legitimacy of the Bank’s bureaucracy as separate from—although still accountable to—its shareholders was established.

Though the issue of management linked to this initial crisis of legitimacy was resolved, the ultimate question of ownership remains. On the one hand, the Articles of Agreement are clear that the Bank is owned by shareholding countries in proportion to the amount of capital that they have pledged to the Bank, something that in and of itself creates a problem of ‘multiple principals’ (Hawkins et al. 2006). But, on the other hand, the Bank must be responsive to the governments that borrow from it. Without its borrowers, the Bank has no raison d’être. In particular, without its middle-income borrowers, the Bank risks losing some of its financial footing. Perhaps most importantly, the Bank is also responsive to the impoverished populations living in the countries to which it lends, interests that may not directly coincide with those of their governments. That the Bank has some responsibility to a number of diverse constituencies may ultimately have contributed to the growth over time in the Bank’s mandate and operations (Pincus and Winters 2002) and to the pattern of contradictory or under-realized policy changes that has afflicted the institution (Weaver 2008).

Along with the legitimacy crisis caused by uncertainty over to whom the Bank was accountable, the Bank also faced an early crisis of relevance brought on by the progress of recovery in Europe. The Bank’s first loans were for European reconstruction, but with the advent of Marshall Plan assistance from the USA, senior officials at the Bank recognized that the organization’s future would lie in development loans to the poorer countries of the world. The Bank, therefore, began lending money to countries like Brazil, Chile and Mexico, though the lending flows were relatively slow as many of these countries were seen as repayment risks.

In the late 1950s, the creditworthiness of two large Bank borrowers, India and Pakistan, became increasingly suspect. Simultaneously, the United Nations system was considering the possibility of creating an organization that would provide development financing at interest rates well below the market rate. The World Bank president realized that the Bank needed to act or else face a crisis of irrelevance (Kapur et al. 1997, 137; Kapur 2002; Phillips 2009). Therefore, in 1960, the World Bank added a new lending arm, the International Development Association (IDA), specifically chartered to lend to the poorest countries of the world at concessional rates and also specifically having the chartered ability to finance social projects (Mason and Asher 1973, 391–94).

According to Bank historian Devesh Kapur, ‘IDA fundamentally transformed the nature of the World Bank … [making it] much less risk averse and willing to experiment especially in
sectors with a direct impact on the poor’ (2002, 56). Since IDA needed triennial replenishments from the wealthy countries of the world, its establishment also fundamentally transformed the ability of the USA and other donor countries to put pressure on the World Bank by creating a regular hold-up point (Woods 2006; Babb 2009).

With the World Bank now defined by the lending flows of both the IBRD and the IDA, over the course of the 1960s the institution became fundamentally reoriented toward poverty alleviation. President George Woods increased Bank involvement in the agriculture and education sectors and began using IBRD revenues to provide additional financing for the IDA (Engel 2009). President Robert McNamara expanded Woods’s initiatives, drastically scaling up World Bank lending and declaring in 1973 that the World Bank’s goal was ‘a world free of poverty’.

As the World Bank’s orientation broadened in this time period, part of the organizational culture changed. As James Ferguson describes, there is ‘a prime institutional need of … bureaucrats to “move money”, to spend the money they have been charged with spending, and to put their resources into action’ (Ferguson 1994, 70, citing Tendler 1975, 88–90). Beginning in the late 1960s and to the present day, World Bank lending decisions have been dominated by a ‘disbursement imperative’ that gives rise to an ‘approval culture’ (Portfolio Management Task Force 1992; see the discussion in Weaver 2008, 83–90 and Phillips 2009; see also Niskanen 1975; Easterly 2002; Hefeker 2006; Berkman 2008; Easterly and Pfutze 2008). World Bank operational staff are rewarded for making loans, that is for moving money out the door. Development impact is difficult to measure, whereas dollar amounts are indisputable; therefore, it is easy to base professional sanctions and rewards on whether loans are made or not.

Although definitive of the decade following McNamara’s departure from the Bank in 1981, it was under McNamara’s presidency that the Bank embarked on a programme of structural adjustment lending. Under McNamara, Bank commitments had increased tremendously, but actual loan disbursements were lagging behind: projects were approved, but the money was not making its way from Washington to the borrowing countries (Sharma forthcoming). Beyond this, even where money was being disbursed, development progress was not following. Some senior Bank officials believed that this lack of development progress was due to the lack of policy reform in borrowing countries (Kapur et al. 1997, 507). In terms of both of outputs (disbursements) and outcomes (development), the Bank was facing a crisis of effectiveness. Structural adjustment lending provided a solution to both parts of the crisis: new loans would be large and fast-disbursing, and they would be brokered in exchange for a commitment to policy reform rather than with the goal of financing specific investment outputs. The balance of payments and debt problems affecting oil-importing countries after the 1979 oil crisis provided an external material environment in which there would be eager customers for this new lending stream (Woods 2006).

The neo-liberal economic policies contained within structural adjustment programmes marked ‘the death knell for the Bank focus on poverty’ (Kapur et al. 1997, 333) and, in many ways, the unmaking of the McNamara bank of the 1970s. During the 1980s, the Bank came to strongly recommend ‘the retreat of the state from economic life and the opening up of economic activity … to the free play of market forces’ (Mosley et al. 1991, 23–24). Adjustment lending increased from 7% of total lending in the 1980–82 period to 26% of lending in the 1987–90 period, while the average number of policy conditions per operation went from 34 to 56 (Kapur et al. 1997, 520–21).

The Washington Consensus policy conditionality found in structural adjustment lending was meant to improve the basic macroeconomic policies in developing countries in such a way that development assistance in general would promote growth more effectively. However, by the
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early 1990s, the World Bank faced a new credibility problem: the link between structural adjustment and economic growth was proving tenuous at best, while the alleged negative externalities to structural adjustment policies were being well publicized by civil society (Mosley et al. 1991; Killick et al. 1998; Easterly 2005; Abouharb and Cingranelli 2007).

Structural adjustment came under fire from many different directions and for many different reasons. Civil society had become critical of the lack of democracy and transparency within the World Bank, and it labelled the Bank as forcing unwanted policy changes on borrowing countries and the people of those countries (Rich 1994; Stiglitz 2002; Wade 2002; Williams 1990; Woods 2006). The austerity measures called for in structural adjustment programmes were quite unpopular in countries where they were implemented (Nelson 1990; Walton and Ragin 1990), and in some cases, the battle over their implementation appears to have led to government repression of citizens (Abouharb and Cingranelli 2006). The distributional consequences of structural adjustment programmes seemed to fall largely on the poor, further costing the Bank political support (Rich 1994). Austerity programmes often led to public spending cuts in areas that not only served the poor but that could, in fact, facilitate development, such as education (Jones 2007).

Beginning in the early 1990s, a series of academic studies about the successes and failures of structural adjustment coalesced around the idea that, where structural adjustment had not been successful in terms of spurring economic growth, the lack of results could be attributed more to failed implementation than to failed design (World Bank 1989; Mosley, Harrigan and Toye 1995; Killick et al. 1998; World Bank 1998; Dollar and Svensson 2000; Svensson 2003). Borrowing countries either did not fulfil the conditions specified in the programmes or else fulfilled them in ways that allowed for bureaucratic box-checking but that did not adhere to the true intent of the conditions. Nonetheless, because of the ‘culture of loan approval’, the loans kept coming (Easterly 2005).

The idea that the shortcomings of structural adjustment were caused by the failure of borrowing states to implement reform policies overlapped with the emergence of the new institutional economics (Fine 2001; Weaver 2008; Engel 2009). This literature argued that markets were at their most effective when they were embedded in particular types of institutions that reduced uncertainty and guaranteed property rights (North 1990). The confluence of the crisis of legitimacy surrounding structural adjustment programming and the discursive environment of the new institutional economics set the stage for the World Bank to embrace governance and anti-corruption programming in the mid-1990s.

**Governance and anti-corruption programming at the World Bank**

As the shortcomings of structural adjustment programming became apparent, the World Bank, picking up on the innovations of the new institutional economics, began referencing the quality of governance institutions as the key variable explaining why development assistance had not had its intended effect. This created a perceived need for action on the issues of governance and corruption (Miller-Adams 1999). In this section, we discuss the translation of this perceived need into action, describing the Bank’s efforts in the 1990s, the 2000s and the 2010s to alter its lending in ways that responded to governance and corruption. We conclude that the GAC agenda, after 20 years, remains fundamentally challenged. In the following section, we examine the latest lending innovation at the Bank, Program-for-Results financing, in light of the challenges that GAC-based lending has faced.

Although poor governance was seen as a hindrance to economic growth even during the McNamara years (Kapur et al. 1997, 478), the World Bank was constrained in terms of action
The World Bank post-structural adjustment

until the 1990s. First, the IBRD Charter prohibits interference in the political affairs of its members. During the Cold War, the developed-country principals at the Bank often had incentives to promote the continued flow of money to poor-governance regimes so long as they were on the right side of the global political divide. This combination of juridical and geostrategic constraints was such that even discussions of corruption were swept aside as violations of the apolitical constitution of the Bank.

In the early 1990s, the Bank began to think more openly about recipient government institutions. In 1991, the Bank’s general counsel ruled that governance issues could be discussed and funded to the extent that they were driven by economic motives (Weaver 2008, 106). Japan used trust fund financing to underwrite the East Asian Miracle study (World Bank 1993), which pushed back against the structural adjustment era’s emphasis on market dominance and the retreat of the state. This document broadened the discourse surrounding the types of state institutions best suited for promoting development.

It was Bank President James Wolfensohn’s speech at the 1996 annual meeting, in which he denounced the ‘cancer of corruption’, that is taken as the signal moment for the emergence of the GAC agenda at the Bank. The following year, the Bank published a key report on combating corruption. The 1997 Strategic Compact included an increase in positions for financial managers and procurement specialists who would look for and try to prevent corruption within projects. Wolfensohn created a special investigative unit that became the Department of Institutional Integrity (Weaver 2008, 123). From around 17% in 1995, governance-related lending as a proportion of total IBRD/IDA commitments rose to 27% in the late 1990s (IEG 2011, Figure 1.1). In terms of both the internal mechanics of lending operations and in the sectorial distribution of such operations, the GAC agenda was being rapidly mainstreamed within the Bank.

In 2000, the Bank published a new strategy for Reforming Public Institutions and Strengthening Governance. It explicitly called for ‘moving institutional development and capacity building to center stage’, emphasizing the reform of core administrative bodies, the civil service, tax administration, public enterprises and legal and judiciary bodies (World Bank 2000, xii–xiii). The report acknowledged the need for country-specific responses, a longer-term lending vision and new skills among staff (World Bank 2000, xiii). The Bank also formalized the Department of Institutional Integrity, incorporated governance measures into its Country Policy and Institutional Assessment index used to allocate IDA funding (see the discussion in Winters 2010), began including anti-corruption plans in Country Assistance Strategies and began producing what are now known as the Worldwide Governance Indicators.

Paul Wolfowitz’s arrival as World Bank president in 2005 intensified the emphasis on governance and anti-corruption; the development of an institution-wide GAC strategy became his ‘signature program’ (IEG 2011, xli). Taking a very hands-on approach, Wolfowitz used the Bank’s strongest weapon, cancelling or withholding loans in at least nine recipient countries (Weaver 2008, 131), including from Chad in the well-known case of the Chad–Cameroon Oil Pipeline Project (Gould and Winters 2007). The GAC agenda was now driving new lending flows and also the suspension of lending flows.

Wolfowitz’s strategy of suspending lending materially confronted the Bank’s disbursement culture, raising concerns among some staff members. Some European donors saw Wolfowitz’s application of punishments as arbitrary and questioned the efficacy. In addition to this ideational challenge, China materially threatened to halt future borrowing if Wolfowitz did not curtail his anti-corruption crusade and his plans to bypass lending to certain governments (Weaver 2008, 134–36; Phillips 2009, 131). Ultimately, Wolfowitz’s crusade was undone by the special treatment of his significant other as a Bank employee, and he was forced to step down as president three months after the Board of Directors had formally approved a new GAC strategy.
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The 2007 GAC strategy document announced that GAC programming was essential to the World Bank’s mandate to reduce poverty. In an explicit reaction against Wolfowitz’s hard-line tactics, the strategy said that the Bank must seek ‘creative ways of providing support’ in poorly governed countries in order to avoid ‘mak[ing] the poor pay twice’ by cutting off funding (World Bank 2007). The document outlined the principles of consistency in operational decisions, supporting country ownership of GAC programming and engaging with a broad range of stakeholders. Building on the international aid effectiveness dialogue expressed in the 2005 Paris Declaration, the document said that the Bank would ‘strive to strengthen, rather than bypass, country systems’ and work to harmonize its programming with other donors (World Bank 2007).

At the same time, the strategy document and the subsequent implementation plan (OPCS 2007) reveals that the tensions in the World Bank’s pursuit of the GAC agenda had not been resolved after 10 years; they remain unresolved today and, as we will show in the subsequent section, appear as tensions also in the World Bank’s latest lending innovation. First, since there is no clear technical roadmap for improving governance, the strategy document lacks an actionable definition of ‘good governance’. There is also a lack of a clear results chain for achieving governance goals. Second, the preference for continued lending in poor-governance situations represents an overly easy compromise with the Bank’s disbursement culture. Third, related to the question of the ownership of the World Bank’s mission, there is an (acknowledged) incompatibility between the Bank’s commitment to fighting corruption in projects that it funds and the Bank’s commitment to strengthening country systems.

In order for an international institution to support governance and anti-corruption, the first precondition is a definition of what these concepts mean. The 2007 strategy defines corruption as an abusive action and provides specific examples of corrupt behaviours (World Bank 2007, i). Governance, on the other hand, is defined as ‘the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services’, a definition that provides no obvious prescriptive direction for action. Whereas the definition of corruption indicates how an observer would know whether levels of corruption are improving (that is there would be lower levels of bribery, patronage, nepotism, theft and diversion), the definition of governance provides no such guidance (Miller-Adams 1999).

The technical challenge of creating good governance is an enduring problem and one that not only the World Bank faces. It is undeniable that there is a strong correlation in the empirical evidence between broad measures of good governance and economic development; the World Bank, like many scholars, accepts the claim that good governance causes economic development (Knack and Keefer 1995; Barro 1998; Acemoglu et al. 2001; Rodrik et al. 2004). Yet, for all of the talk about the importance of good governance in both the academic world and the world of development practitioners, there are few concrete suggestions about how to bring it about.

This should not be a surprise. There is no teleology by which rapacious state institutions that specialize in securing rents for vested interests and extracting surplus from a weak citizenry evolve into accountable and responsive state institutions that excel in service delivery and welfare provision. Rather, some sort of shock to the system is necessary, and then the form of change that affects the institutions in the system will reflect the array of power and interests within the system (Collier and Collier 1991; Greif and Laitin 2004; Acemoglu and Robinson 2006, 2012).

Structural adjustment lending, for all of its failings, had an intellectual foundation that prescribed specific actions: government policies on trade, subsidies, exchange rates and state-ownership of businesses that can be changed directly. There may be unanticipated political
obstacles to enacting the relevant legislation or ex post implementation problems, but the mechanics of shifting from de jure high tariff barriers to lower ones are not themselves a mystery. However, since social scientists have not yet been able to specify the mechanics for creating good governance, the World Bank embarked on a mission of generating good governance without a clear roadmap of how to do so.

Because of this, 10 years into the GAC era, it was clear that the anti-corruption part of the agenda was much better defined than the good governance part of the agenda. This remains true today. The superior clarity of what corruption is and how to combat it makes it easier to set goals with empirical indicators and create operational policy that helps achieve those goals. The Bank’s support for good governance has been conceptually constrained throughout the life of the GAC agenda, and the tensions between the principals whom the World Bank seeks to serve only exacerbate the difficulties. According to the 2011 IEG evaluation, ‘[T]he strategy defined “GAC” too loosely to be coherent … enabling the Bank to satisfy various external constituencies but … also allowing numerous Bank units to legitimize their disparate agendas and vie for scarce internal resources’ (IEG 2011, 26, citing Weaver 2008).

Similarly, the strategy lacked a clear results chain by which certain inputs led to World Bank outputs that facilitated the intermediate outcome of improved governance in pursuit of the long-term outcome of poverty reduction (see the discussion in IEG 2011, Ch. 2). Therefore, the implementation indicators discussed in the strategy and implementation plan focused mainly on things that the Bank was doing (i.e. outputs), rather than focusing on the manifestation of country governance itself (i.e. outcomes). This lack of vision with regard to how certain World Bank activities and products translate into changed governance made the 2007 strategy less effective than it could have been in terms of providing operational direction for World Bank lending. The IEG evaluation blamed this lack of a results chain for the fact that, ‘by the end of its third year, [the strategy’s] original goal of making systematic and time-bound improvements in the GAC responsiveness of operations was no longer widely recognized by key staff’ (IEG 2011, xix).

Second, the 2007 GAC strategy included an easy compromise between the harsh Wolofowitzian tactics of interrupting lending and the Bank’s lenient disbursement culture: the Bank simply committed to remaining engaged in poor-governance countries. The imperatives of disbursement culture were more broadly reflected in the focus of the 2007 strategy on World Bank outputs. As described in the 2011 evaluation, the implementation plan focused primarily on ‘training Bank staff and augmenting the Bank’s budget’ and then on communicating these ‘GAC efforts rather than [the] delivery and documentation of governance results’ (IEG 2011, 31)—that is, on communicating outputs rather than outcomes. As Jeffrey Winters expressed 10 years earlier, the World Bank suffers from ‘an institutional compulsion to respond [to corruption] in ways that tend to generate additional lending and require the provision of expensive technical expertise’ (Winters 2002, 103). This problem is widely accepted within the Bank: nearly 50% of World Bank staff agree with the statement that ‘the Bank’s lending imperative conflicts with its ability to implement the GAC strategy’ (IEG 2011, xvii).

Third, the strategy is challenged to resolve the tension between protecting Bank resources and using country systems. The document notes that the Bank ‘has a fiduciary obligation, enshrined in its Articles of Agreement, to ensure that its funds are used for their intended purposes’ (World Bank 2007, ii). This responsibility—while important—leads to a desire within Bank operational units to ‘ring-fence’ projects, that is, to seal them off from potentially corrupt country systems by establishing parallel implementation, monitoring and auditing structures. The strategy itself acknowledges that ring-fencing is ‘a straightforward way of addressing fiduciary risks’ (World Bank 2007, 24).
Introducing fiduciary protections into investment operations comes directly into tension with improving country systems through alignment with them. According to the IEG review, Bank staff receive ‘mixed messages on GAC’: ‘[e]ven though [use of country systems] was a core GAC principle, the evaluation found that the perceived risk of complaints to the Integrity Vice Presidency and the possibility of ensuing investigations encouraged ring-fencing of Bank projects’ (IEG 2011, 88). The likelihood of negative professional consequences linked to easily identifiable manifestations of corruption in a single project is much greater than the likelihood of professional rewards for using country systems, where it will be much more difficult to attribute improvements in those systems to a particular instance of usage.

This emphasis on the fiduciary protection of projects is representative of the extent to which the GAC agenda has been light on ‘G’ and heavy on ‘AC’. Having combined its mission to improve governance with a more specific anti-corruption mission, the almost obvious result is that ‘GAC efforts have focused on measures to enhance the integrity of transactions in Bank investment projects’ (IEG 2011, 52). The Bank has done exactly what it is most capable of doing: monitoring and auditing specific fiduciary transactions and punishing fraud when it is revealed. Results from an IEG survey show that World Bank staff are 10 percentage points more likely to say that ‘GAC-in-projects’ material is relevant or usable than they are to say that ‘GAC-in-countries’ material is (IEG 2011, Figure 5.1). Therefore, the choice between project-specific measures and the use of country systems ends up being heavily weighted: take the clear and obvious steps to prevent corruption rather than expose resources to fiduciary risks for abstract and imprecise institutional-strengthening goals.

When it comes to having clear plans for reducing overall corruption within countries, the World Bank again has been constrained—for purely intellectual reasons, to begin with. According to the 2011 evaluation, the Bank has focused its support on supreme audit institutions and anti-corruption bodies, but the ‘impact [has been] heavily dependent on the independence and political composition of legislatures’ (IEG 2011, 92). Where committed reformers exist and have power, the Bank has been able to support good governance institutions.

Ultimately, the World Bank is faced with an unenviable dilemma when it comes to its assumed mission of creating better governing institutions in the developing world. All alternatives ultimately harm one or more key constituencies. The Wolfowitzian approach of withholding funds from states that do not practice good governance helps to ensure that World Bank monies are well spent but limits the potential impact that the World Bank can have on providing immediate help for the world’s poor. However, it is unlikely that this approach will lead to meaningful changes in governance outcomes; there is no record of a case in which withholding loans has created so much instability that the recipient government feared for its continued existence and therefore instituted change. An approach of bypassing corrupt governments may benefit both lender states and the poor, but it still leaves borrowing states unsatisfied and does little to help bolster institutional capacity. There is always the option of tolerating poor governance in the hopes that development will spur governance growth in and of itself, but institutional imperatives aside, the reigning academic wisdom suggests that economic growth is unlikely to happen in poor governance situations.

The latest innovation at the World Bank: Program-for-Results financing

As is standard when the Internal Evaluations Group issues a report, World Bank management produced a response to the findings of the 2011 IEG evaluation of the 2007 GAC strategy. In responding to the recommendation that management update the Bank’s approach to institutional strengthening, management noted the ongoing development of ‘a new results-based
lending instrument that will finance the delivery of results in many of the critical areas listed by IEG’ (IEG 2011, xxxi). The lending instrument in question was Program-for-Results (P4R) financing, approved by the Board of Executive Directors in January 2012—the first approval of a new type of lending instrument since the introduction of structural adjustment lending in 1980.

The push to create P4R originated in crises of effectiveness and legitimacy facing the entire development industry. The discourse of the global aid effectiveness movement establishes country ownership of programming as its first principle, and then alignment and the use of recipient country systems as its next key principles. By paying countries for development results that have been achieved, P4R can be seen as more legitimate and more effective than traditional foreign aid lending instruments.

Although clearly driven by much more than the desire to implement the GAC strategy, World Bank staff have consistently emphasized P4R’s institution-building benefits in talking about the instrument. However, the three fundamental problems in the Bank’s GAC programming are equally detrimental both to P4R’s institution-building mission and to its more general development mission. Though the newness of P4R limits our ability to discuss its implementation, we observe that P4R is unlikely to offer a solution to these problems. We look at some of the ways that the problems have manifested themselves in the drafting of P4R, consultations surrounding P4R and the first P4R loans.

The Program-for-Results instrument occupies a middle position between the World Bank’s policy lending, which disburses against policy or institutional reforms, and its investment lending, which disburses against within-project expenses. P4R projects disburse against the achievement of specific indicators. In other words, P4R funding is intended to be an after-the-fact transfer for programmes that a country has undertaken after initial agreement with the World Bank. Such results-based financing has been promoted as a form of foreign aid that induces increased accountability and, therefore, effectiveness (Mumssen et al. 2010; Birdsall and Savedoff et al. 2011; for a somewhat more sceptical view, see Pearson et al. 2010).

In the 1990s and 2000s, Bank staff had tried to do programmatic, results-based lending using either the investment or policy-lending instruments, but they were limited with those instruments. Specifically, investment lending’s strict procurement restrictions made it difficult to finance projects in an output-based fashion. This led to ‘project designs … biased toward activities that are easier to accommodate within the current Bank procedures rather than being primarily driven by delivering maximum results’ and also to ‘cherry-picking’ specific financeable activities rather than focusing on ‘the effectiveness and efficiency of the entire program’ (OPCS 2011, 8). As the concept note for P4R says, this ‘“muddle-through” approach [resulted] in inconsistent and selective application of programmatic approaches … with missed development opportunities and significant frustrations to borrowers and Bank staff’ (OPCS 2011, 36). OPCS Head Joachim von Amsburg said that many borrowing countries considered P4R to be ‘a long-overdue innovation’ (CGD 2012).

Consultations in which the World Bank engaged with stakeholders during the development of P4R revealed dissatisfaction with many elements of GAC that the World Bank was attempting to address with a more results-based programme. Acknowledging the difficulties of building better governance institutions in the developing world, the World Bank routinely pointed out that capacity-building was a key part of P4R (World Bank 2011a, 2011b, 2011c, 2011d), and that they ‘had a good sense of what had not worked in the past with respect to capacity building and felt [P4R] had a much better chance of success’ (World Bank 2011a, 3). In principle, P4R’s results-based focus also addressed a key criticism brought up in the 2011 IEG evaluation of GAC: the issue of rewarding outputs rather than outcomes. The World Bank noted that the kind of results-based lending that is undertaken with P4R provides a greater
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opportunity to focus on capacity-building than the output-based lending that has taken place under the investment lending instrument (World Bank 2011d). Thus, while not a replacement for investment lending, nor the procedures and safeguards used in those projects, P4R’s construction addressed some of the key criticism levelled against GAC lending’s ability to catalyze meaningful institutional change.

Despite significant support from within the World Bank for P4R, some external voices were more sceptical. NGOs worried that P4R funding could be used to finance interventions that have serious negative environmental and social consequences. These NGO concerns influenced the most important shareholder country at the Bank, the USA. The US Treasury Department issued a position paper arguing that P4R be rolled out gradually and with projects triggering the highest level of safeguard alerts excluded from the instrument (United States Department of Treasury 2012). The Bank agreed to these limitations, restricting P4R financing to no more than 5% of Bank lending in its first two years and excluding projects rated ‘Category A’ under the Bank’s safeguards system. (The restriction on the volume of lending will prevent a meteoric rise in commitments like that seen in the early 1980s after the creation of structural adjustment lending.) In addition, the Bank reserved the right of the Integrity Vice Presidency to investigate ‘all allegations of fraud and corruption in the entire program supported’ (OPCS 2011, 48; Nancy Birdsall describes these outcomes as a compromise in CGD 2012).

In general, the presentation of P4R was such that it was complementary to the aid effectiveness discussion in the broader development environment. The instrument necessarily uses country systems, since World Bank financing arrives ex post. In addition, the new instrument was presented as complementary to the GAC strategy. P4R is supposed to ‘support government programs using the program’s institutions and systems, thereby building their capacity’ (OPCS 2011, 43). In addition, the Bank’s concept note argues, ‘Linking Bank financing to verifiable results is itself an indicator that funds are used appropriately. … [T]he verification protocols for [results] will assign clear accountability, the disclosure of program results will increase transparency’ (OPCS 2011, 46).

Both in terms of aid effectiveness and building good governance, P4R seems soundly oriented. However, the three fundamental problems that have affected the progress of the GAC agenda are equally likely to affect the progress and development effectiveness of P4R.

First, the notion that the use of country systems is a means to improve governance is incomplete, belying the lack of a technical roadmap for governance strengthening. Use alone will not improve corrupt or low-capacity institutions. The Bank recognizes this and states, ‘A priority area for both preparation and implementation support will be to strengthen the capacity of the institutions to implement the program’ (OPCS 2011, 9), which might happen either through direct technical assistance or else by incorporating governance results into P4R lending (OPCS 2011, v, 15). But, as with the GAC agenda overall, this is much easier said than done.

Aware of the risks entailed in using country systems, the concept note specifies that P4R operations need to be preceded by a technical assessment, a fiduciary systems assessment, an environment and social risks assessment and an integrated risk assessment. In other words, P4R operations will use country systems but only after thorough review of all aspects of those systems. In the words of Nancy Birdsall of the Center for Global Development, this risks making P4R lending ‘investment-lending-plus’ (CGD 2012).

In June 2012, the Bank’s Executive Board approved the first two P4R operations. One loan to Morocco was the extension of the National Initiative for Human Development, a community-driven development programme that operates largely through civil society organizations, with government systems providing monitoring and auditing functions. The other loan, to Nepal, was for a Bridges Improvement and Maintenance Program. All financing from the World Bank within the loan will flow through Nepal’s own country systems, such that the ‘Department of
Roads will see no difference between [Government of Nepal] funding and the Bank’s support’ (World Bank 2012b, 6).

Within the loan to Nepal, 55% of funding will disburse against maintenance activities undertaken by the Department of Roads, 30% against construction and upgrading activities and 15% against performance management. The three disbursement-linked indicators (DLIs) for the capacity-building objectives of the loan have clear goals, providing some insight into how the Bank will undertake governance programming in the context of P4R lending. Performance management will be measured by the percentage of works completed on schedule. Asset management will be measured by the number of districts in which a new bridge management system is operational and by the percentage of the strategic road network that is surveyed annually. Institutional effectiveness will be measured by the development of a grievance mechanism in the first year and the production of reports on complaints and subsequent actions over the next four years (World Bank 2012b, Table 2).

On the one hand, these indicators are relevant, clear and, prima facie, demanding. In order for the loan to disburse against asset management, the Department of Roads must roll out the bridge management system over two years and then survey 20% of the strategic roads network each year over the next three years. To disburse against performance management, the percentage of works completed on schedule needs to steadily increase each year (although the DLI demands only a 50% on-time completion rate in the final year of the project). On the other hand, the institutional effectiveness DLI does not explain how it will measure the value of the report on complaints or the value of the actions reportedly taken against fraud and corruption. This is not to say that these GAC-related DLIs are not capable of helping improve capacity within the Department of Roads in Nepal. If the DLIs are taken seriously by individuals in the highest ranks of the Department of Roads and the Ministry of Finance, they may very well create the right incentives to catalyze performance improvements within the relevant agencies. As compared to the DLIs linked to performing maintenance bridges, however, the outputs in the governance-related DLIs are necessarily more subjective and more susceptible to interpretation.

With regard to the second fundamental tension within the Bank’s GAC programming, the disbursement culture that drives bureaucratic decision-making in the Bank risks quickly introducing a number of pathologies into P4R lending. Nancy Birdsall raises several points on how World Bank staff might react to the new instrument. First, because results will take time to appear, there may be a disincentive for task team leaders to support projects where there is a risk of disbursement being delayed for a number of years until the government has found the best way to meet targets. This would limit the necessary policy experimentation in which governments should engage (CGD 2012). More importantly, disbursement incentives threaten to undermine the results focus of P4R:

[The big question is] will the Bank disburse when there isn’t a result that has been agreed? ... [W]ill it disburse in a sensible way proportionally if results are half-achieved, or will there be, once again, the pressure to disburse annually, as planned?

(CGD 2012)

The Technical Assessment of the P4R lending to Morocco discusses disbursing funds in a manner commensurate with achievement. The document describes how achieving only 60% of a result would result in a payment of only 60% of the agreed upon amount for the relevant DLI (World Bank 2012a, 48).

In addition, task-team leaders may have incentives to build too many indicators into projects so that they will always be able to find accomplished targets against which they can
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disburse—similar to what often happened in structural adjustment loans (CGD 2012). The P4R loan issued to Morocco does little to assuage this concern; there are a total of nine ‘disbursement-linked indicators’ included in the project, the disbursement against each of which ranges from 7% to 13% of the value of the loan.

Another aspect of P4R suggestive of the new instrument not offering a solution to the problems of disbursement culture is the way that the World Bank chose to handle the issue of verification. P4R does not require the mandatory use of third-party verification of results. Allowing the same World Bank bureaucrats that are rewarded for disbursement to assess results creates the concern that assessments will be done in a way that allows for a greater amount of disbursement.

Third, the question of to whom the World Bank should be most responsive remains. If the World Bank exists to provide financing for borrowing countries, then P4R projects are likely to include indicators against which it is easy for the World Bank to disburse. If the World Bank exists to improve the lives of impoverished populations in borrowing countries, then it perhaps must truly demand the achievement of results before disbursement. (The counterargument, however, is also logical: if the government uses up resources on a programme that it expects the World Bank to disburse against, the resulting budget shortfall from non-disbursement may harm the poorest, such that the World Bank should disburse the money despite the lack of results.) If the World Bank exists to serve the interests of its major shareholders, then P4R provides a convenient mechanism through which the Bank can support the programming of other donor nations. However, some donors explicitly worry that P4R might weaken the Bank’s environmental and social safeguards (United States Department of Treasury 2012; World Bank 2011h); borrower governments, such as Argentina, on the other hand, bristled at the idea that World Bank safeguards should apply to projects being financed from their own coffers (World Bank 2011f, 2011g).

**Other results-based programmes**

Program-for-Results financing is representative of a number of results-based initiatives within the Bank that attempt to address the crises of legitimacy and effectiveness being faced by development institutions. In line with the general move in development economics toward rigorous impact evaluations conducted in the field (Banerjee and Duflo 2011; Karlan and Appel 2011), the World Bank created the Development Impact Evaluation Initiative (DIME) in 2005 and re-launched it in 2009. DIME funds impact evaluations within World Bank projects; as of mid-2010, DIME had contributed to 170 completed and 280 active studies across 72 countries (Legovini 2010). DIME is explicitly aimed at generating knowledge about the effectiveness of development programming and policies, and thereby responds to concerns about the effectiveness and legitimacy of the World Bank as a development institution.

The data underlying some of the DIME evaluations, like much other data collected or produced by the World Bank, has been made available through the Bank’s website. The Bank embarked on the Open Data initiative to allow anyone in the world easily to ‘find, download, manipulate, use, and re-use the data compiled by the World Bank, without restrictions’ (World Bank 2010). As of the end of 2012, there were 8,000 time-series indicators, 850 datasets about World Bank financing, data from 11,000 World Bank-funded projects and 700 survey datasets available (World Bank 2013). Making its data on development available to the public helps the Bank to respond to critics who say that it is non-transparent or undemocratic: both data on specific World Bank operations and also data that the World Bank has collected for academic purposes can now be examined. Ultimately, then, the World Bank hopes that this data
openness will lead to development innovation through crowdsourcing, answering a crisis of legitimacy with an initiative that potentially also addresses its crisis of effectiveness.

**Conclusion**

In this chapter, we have provided a historical overview of major changes in the structure of lending at the World Bank, focusing in particular on the evolution of the governance and anti-corruption programming that became a main pillar of the Bank’s agenda in the mid-1990s and also the new Program-for-Results instrument. Change and innovation within the Bank have been driven by periodic crises of relevance, effectiveness and legitimacy. But fundamental tensions underlie the changes that we have discussed in this chapter, and these tensions eventually will result in new concerns about the continued relevance, effectiveness and legitimacy of the Bank as the world’s premier development institution.

We have highlighted three internal tensions. First, the lack of a clear roadmap for improving governance has stunted the governance component of the GAC agenda and means that the pathways by which P4R lending will improve governance are unclear and perhaps overstated. Second, the disbursement culture at the Bank has led to GAC lending that focuses on measurable outputs and has constrained the Bank’s ability to use the suspension of lending as a tool. This disbursement culture also threatens to dilute the effectiveness of P4R lending by undermining the incentive structures that are core to the success of the new instrument. Finally, the Bank remains beholden to multiple masters. Depending on whether it is responding to the developed country governments that supply IDA financing and hold the majority of voting shares within the Bank, or the developing country governments that borrow from the Bank, or the developing country populations that are supposed to benefit from the Bank’s programming, the World Bank is pulled in different directions. This makes it easy to argue instrumentally for or against increased use of country systems, for instance. This again has affected both the implementation of the GAC agenda and looms over the implementation of P4R projects.

Though the World Bank has struggled and will continue to struggle with the problems of building better governance institutions in the developing world, its own disbursement culture, and the issue of to whom the Bank is accountable, the institution has on the whole been an important and positive actor for international development. However, more can be done by the Bank to limit the pernicious effects of the enduring problems that we have identified.

Within P4R, the use of third-party verification is one way to limit the impacts of disbursement culture. By ceding verification of results to a neutral party, the World Bank should be able to limit the incentive that bureaucrats have to disburse against results that have not been achieved. If the culture of loan approval is successfully mitigated, this could also lead to disbursement only after country systems have improved, as states that lack good governance are theoretically the least likely to achieve DLIs, even if those DLIs do not relate directly to governance outcomes. Additionally, allowing state participation in the process of specifying DLIs creates greater opportunities for country systems to be used effectively without creating counterproductive strains on the capacity of institutionally weaker states. Greater participation, both by developing states and by non-state actors, is a trend that helps ensure World Bank accountability to all of its stakeholders. While the World Bank may always face the dilemma of to whom it is accountable, the World Bank’s efforts to encourage greater participation facilitate the Bank’s balancing of the desires of the stakeholders as judiciously as possible.

Despite the concerns that we have raised, we ultimately believe that the changes at the World Bank in the post-structural adjustment era have been for the better. The emphasis on anti-corruption has introduced new safeguards and monitoring into Bank projects. A results-based
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lending stream provides opportunities for the World Bank to assist in creating incentive structures that bring about development success in borrowing countries. The continued (and sometimes increased) use of the World Bank in the post-structural adjustment era speaks to the fact that there are developing and middle-income countries that want to take advantage of the Bank’s services (Winters 2011). The World Bank remains a vibrant and integral part of the global financial architecture.

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——‘Feedback Summary’, Brasilia, Brazil, 18–20 May 2011b.


——‘Multi-Stakeholder Consultations, Feedback Summary’, Cairo, Egypt, 26 April 2011d.

——‘World Bank Consultations with the Private Sector in France on the Proposed Program-for-Results Lending Instrument’, MEDEF, France, 4 April 2011e.

——‘Program-for-Results Lending Consultation: Argentina’, Washington, DC, 23–24 May 2011f.

——‘Multi-Stakeholder Consultations’, Accra, Ghana, 19 April 2011g.

——‘Key Questions/Comments Raised During Program-for-Results Consultations at the Federal Ministry for Economic Cooperation and Development in Berlin 2011’, 8 April 2011h.


The UN and global development

Stephen Browne

Development has been one of the four principal pillars of the UN since its inception in 1945, along with peace-keeping, human rights and justice, and humanitarian response. The organizations concerned are loosely grouped into a ‘system’ and they have certain characteristics in common, including a putative adherence to UN values. This chapter looks at the current structure of the system, its four principal functions and, within them, its mixed record as a supporter of development goals.

The chapter goes on to review the growing challenges facing today’s UN development system (UNDS). These are both of structure and of substance. Increasing fragmentation has resulted from the manner in which the system has evolved; today the system is characterized by atomization, duplication of effort and unhealthy competition. The system remains heavily dependent on traditional developed country donors, which patronize individual organizations through contributions that are increasingly earmarked. This patronage is especially prevalent in the UNDS’s technical assistance, which is most visible at country level. Thus, increasingly, the supply-sided nature of aid is underscored by the transmission of donor agendas through the UN, blurring the distinction with bilateral assistance and calling into question the multilateral legitimacy of the UNDS. Partly as a result of these systemic weaknesses of the UNDS, many parallel organizations have emerged to challenge the primacy and continuing relevance of the UN in some domains.

The challenges confronted by the UNDS are well amplified in a recent global perception survey of the system, which also suggests the elements of an urgently needed reform programme. Change, however, is unlikely to come soon, if at all. There is little motivation either from within or from outside to reform a system which, while not very effective in terms of development support, enjoys a comfortable relationship with the member states. The best that can be hoped for is that the UNDS begins to focus greater attention on the development tasks for which it is still best suited, such as support to fragile and recovering states.

Structure

Development activities account for about 60% of annual UN spending (over US $13,000m.), employing 50,000 people, a majority of the full-time staff. The ‘system’ which engages in UN
development activities in developing and transition-economy countries includes more than 30 funds, programmes, organizations, offices and agencies. Supporting the system, there are also several functional commissions and research and training organizations. (The World Bank Group is also a ‘UN specialized agency’ but is outside the common staff administration, is independently governed and not normally counted as part of the UN development system.)

The organizations of the UNDS share long-term development objectives and subscribe to the UN’s Millennium Development Goals (MDGs), and there is a common system of salary levels and staff hierarchy. Almost every part of the UNDS is also a member of the UN Development Group, which oversees operational activities at the field level. To that extent, there is a system behind the UN’s development pillar.

An outstanding characteristic of the UNDS, however, is its organizational complexity, as can be seen from Figure 18.1 and Box 18.1. One reason for its complexity is that it was never conceived holistically, and it has grown by accretion over a period of almost 150 years. The only legislation governing the formalization of the system was contained in Chapter IX of the UN Charter of 1945, entitled International Economic and Social Cooperation. In words redolent of the prevailing economic orthodoxy, the UN was to promote ‘higher standards of living, full employment, conditions of economic and social progress and development … solutions of international economic, social, health, and related problems; and international cultural and educational cooperation’ (UN 2006, 37). Some pre-existing global intergovernmental bodies were ‘brought into relationship’ with the UN as specialized agencies. Two of these organizations dated from the 19th century. The International Telecommunication (formerly Telegraph) Union (ITU) and Universal Postal Union (UPU) were founded in Switzerland in 1865 and 1874, respectively. The International Labour Organization was more recent, but
The UN and global development
dated from 1919. From 1945 onwards, many other organizations have been created under UN auspices, either as specialized agencies or as parts of the UN organization itself, under the authority of the Secretary-General and the General Assembly. The most recent additions to the system have been the World Tourism Organization in 2003 (originally founded under a different name in 1946), which joined as a specialized agency, and UN Women, created within the UN secretariat in 2010 as an amalgam of several pre-existing programmes.

The system is also disparate in governance and mandate. The seats of the different entities are in 15 different countries (and 16 cities). There are also more than 1,000 representative offices of the UNDS world-wide (and over 1,400 for the UN as a whole), and the number continues to grow. All entities of the system report to the UN’s Economic and Social Council (ECOSOC). However, because the 14 specialized agencies have their own memberships and governance systems, ECOSOC exercises a very limited writ (Weiss 2010; Browne 2011).

<table>
<thead>
<tr>
<th>Box 18.1 The alphabet soup</th>
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<tr>
<td><strong>Funds and programmes</strong></td>
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<tr>
<td>UNICEF</td>
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<tr>
<td>WFP</td>
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<tr>
<td>UNCTAD</td>
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<td>ITC</td>
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<td>UNEP</td>
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<tr>
<td>UN-HABITAT</td>
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<tr>
<td>UNAIDS</td>
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<tr>
<td>UNGEI</td>
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<tr>
<td>UN secretariat</td>
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<tr>
<td>UNDESA</td>
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<tr>
<td>UNODC</td>
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<tr>
<td>UNOPS</td>
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<tr>
<td>Regional commissions</td>
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<td>ECA</td>
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<td>ECE</td>
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<td>ECLAC</td>
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<td>ESCAP</td>
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<td>ESCWA</td>
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<td>Specialized agencies</td>
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<td>ILO</td>
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<td>FAO</td>
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<tr>
<td>UNESCO</td>
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<tr>
<td>WHO</td>
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<tr>
<td>UNIDO</td>
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<tr>
<td>IFAD</td>
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<td>UNWTO</td>
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<tr>
<td>ICAO</td>
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<tr>
<td>IMO</td>
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<tr>
<td>ITU</td>
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</table>
The UN development mandate

The UN Charter’s abstract definition of the development mandate was founded on a rationale of ‘cooperation’. In practice, UN co-operation has come to be realized in four broadly different ways.

The first and most straightforward is the technical standards function. States find a common purpose in international co-operation in order to resolve problems caused by interdependent relationships. Interstate communications begat the ITU and the UPU in the 19th century because of the imperative to apportion international wavebands and to allow mail to travel across borders. These two UN specialized agencies, along with five others created subsequently—IAEA, ICAO, IMO, WIPO and WMO—are the seven purest functional agencies, responding to specific and universal technical needs. They establish common technical standards that are fundamental to international collaboration. Some other parts of the system are also ‘functional’ in the Mitrany sense (1966) insofar as they help develop universal standards: WHO for health (and with FAO, for food safety) and ILO for the workplace (Lee 2009; Shaw 2009; Hughes 2011).

The second type of co-operation is the generation of public information goods, in the form of statistics, surveys and studies. From the outset the UN has collected statistics from its member governments, screened and processed them for robustness and comparability, and published regular compendia on a wide range of subjects.

The third, more idealistic, type derives from the need for co-operation through international organizations wherever there are shared perceptions of a problem and a readiness to develop a consensus around values and norms embodied by such organizations. This ‘cognitive condition’ (Rittberger and Zangl 2006) is the basis of interstate co-operation through the UN and the closest approximation to global governance in key domains.

The fourth type of UN development assistance may be termed vertical co-operation, the rationale for which was the benevolent transfer of expertise (technical assistance, TA) from richer to poorer countries. TA has become the dominant, and within developing countries certainly the most visible, manifestation of the global activities of the UNDS. As we shall see, however, this predominant form of UN development assistance has followed more of a ‘realist’ than an altruistic form of international co-operation.

The UNDS organizations and their functions are shown in Table 18.1.

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<td>World Meteorological Organization</td>
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<td>International Atomic Energy Agency</td>
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<td>Training and research institutions</td>
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(continued)
### Table 18.1 Overview of UN development system

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<th>Intergovernmental co-operation, policy, conventions</th>
<th>Technical assistance</th>
<th>Staff*</th>
<th>Approx. annual expend. (US $m.)</th>
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<td>16,860**</td>
</tr>
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</table>

Source: FUNDS project

* excluding short-term and project staff

** includes humanitarian and emergency assistance of approximately $3 billion
Challenges

The UNDS today faces two types of challenges: of structure and of substance. It is useful to review them in a historical context.

Structure

As already noted, the UN supports development through a complex panoply of organizational entities. The system is a potentially rich source of expertise and experience, but it lacks a central focus. There is no authoritative centre, nor is there a head of UN development who could oversee coherence in policy and operations, and ensure that knowledge is managed across the system.

The need for a central mechanism of co-ordination was anticipated very early on in the UN’s existence. In 1950, the Expanded Programme of Technical Assistance (EPTA) was created as the central funding mechanism for the UN’s operations on the ground. It had a governance structure that facilitated system co-ordination, but not integration and coherence. Under the auspices of ECOSOC, a TA Committee (TAC) was established. The TAC oversaw the TA Board (TAB), which comprised the heads of the main technical agencies and was chaired by the Secretary-General. Since EPTA was the main (although not quite the exclusive) source of TA funding for the system, the different organizations had every interest in collaborating.

However, a serious fault-line in this structure was agency rivalry for the funds available and the solution proposed to mitigate it. The main beneficiaries of the fund were the original nine specialized agencies (FAO, UNESCO, WHO, ILO, ICAO, IAEA, UPU, ITU, WMO) and the UN secretariat itself, which had established its own Technical Assistance Administration (TAA). From the early stages, the UN could have established its own authoritative strategic console or mechanism to review objectively development needs across the developing world and apportion funds to the agencies accordingly. But no centre was established and instead a passive bureaucratic solution was devised, which assigned fixed apportionments of funding to each agency, as a response to their concerns to ensure continuity in the management and staffing of their TA programmes. It has to be acknowledged that balance is difficult in any multilateralism system. However, giving guarantees to the agencies was clearly at odds with the aspirations of developing countries to present proposals to EPTA for funding based on their own specific development priorities.

The entitlement concept was taken a step further when the UN began to establish the practice of country programming from the early 1950s. The idea of helping countries to develop rolling fixed-year plans for their TA needs was a sound means of helping them to articulate their needs. However, alongside these programmes, funding entitlements were established for each country based on criteria that included population size and levels of per capita income. Concomitantly, the UN agencies sought to ensure that each had its own share in these individual country entitlements, which only served to distort the expressions of ‘need’. Agencies aggressively sought to ‘sell’ their pre-funded expertise, directly to individual countries, as well as through pressures on the local UN representatives. As the first chairman of the TAB (David Owen) was to put it: ‘logically it was extremely difficult to reconcile integrated planning within countries with the concept of a percentage allocation of funds to the specialized agencies’ (Heppling 1995, 48). Fixed shares were only abolished in 1961.

So, as early as the 1950s, one of the most fundamental weaknesses of all development aid—its supply-sidesness—had become a principal characteristic of the UNDS. Funding was provided up front by the richer developed, rather than the requesting, countries. The amounts were then
divided up among the agencies of the UNDS. And fixed entitlements were established for each of the developing countries, a system which was only partially relaxed in the 1990s. With these features, UN assistance was little different from bilateral aid programmes. The system became an elaborate purveyor of patronage from richer countries to poorer countries, ensuring that donor interests—finessed through the priorities of UN agency secretariats—were served in country programming, and undermining any aspiration for country ownership by the recipients. These features have scarcely changed.

EPTA had no strategic leadership, but its role as repository of a central fund contributed to a modicum of cohesion within the system. However, the centre did not hold. Individual agencies saw advantage in seeking funding for their TA activities directly from donor countries willing to patronize them and the system became increasingly atomized as the significance of the central funding mechanism declined.

Seeking to restore cohesion to the TA system, a new and more powerful centre was conceived with the establishment in 1966 of the United Nations Development Programme (UNDP) (Murphy 2006; Browne 2011). UNDP was an amalgam of two funds. One was EPTA and the other was the larger Special Fund (SF), established in 1959 for pre-investment activities.

By 1968, at a time when development assistance was being comprehensively reassessed, two commissions were set up, both reporting the following year. One was the Pearson Commission on international development, set up at the behest of the World Bank, which produced *Partners in Development* (Commission on International Development 1969). The other was a group led by Robert Jackson, which yielded *The Study of the Capacity of the UN Development System* (United Nations 1969). The two commissions were linked. Pearson’s Commission, which included W. Arthur Lewis, the Nobel laureate who had worked closely with EPTA, saw the need for reform of the UNDS if it was to become more effective. Jackson was charged with making it so. The *Capacity Study* followed Pearson by three months and was the first and still the most comprehensive attempt to bring the UNDS into greater alignment.

Jackson advocated for UNDP to play a strong role at the centre with funds as well as ‘brains’ (Murphy 2006). He wanted a harmonized information system, and he wanted to strengthen the field system. But change had to be debated and agreed by UNDP’s Governing Council, and the results fell well short of Jackson’s vision of the future. The most significant practical upshot was agreement to bolster the field system with full-fledged country programming and more authority to the UN’s local representatives, who were instrumental in interpreting local country needs. But, without the restoration of a strong centre, the consequence of devolution to country level was further atomization of the system, manifested by a huge expansion in the number of country and regional offices maintained by different organizations.

There were several reasons for the failure to reform. One was certainly the incapacity of intergovernmental forums to agree to radical change. Another reason was that the reform proposals were already too late. Over more than 20 years, the specialized agencies had developed a high degree of autonomy, both in programming and funding. The larger agencies especially had diversified their sources away from UNDP, and the major donors were willing patrons of their preferred organizations. Cohesion would have required a fully centralized pooling of funds, managed by an authoritative mechanism responsible for apportionment on the basis of need.

UNDP had neither the mandate nor the inclination to play a central co-ordinating role. While agencies chased the same traditional donors for support, UNDP itself abandoned its presumptive role as primary TA funder by pursuing its own destiny as a full-fledged development organization. UNDP became a rival with the rest of the system, not just on the doorsteps
of the donors, but in the field, where many of its TA activities began to duplicate with the rest of the system.

In 1977, the General Assembly tried to bring more coherence to country programming by designating UN resident co-ordinators to act as local system convenors (UN 1977). Because UNDP had its own representatives in every country, and with the broad-based development mandates which it had given itself, it had first claim as co-ordinator, and the Secretary-General acquiesced. But the ambiguity of this dual role of resident co-ordinators, as both convenors and competitors, undermined trust within the system. Nowhere was this more apparent than in 1992, when the UN established its own ‘unified offices’ in some of the newly independent former Soviet republics. UNDP supplied the UN representatives in most cases (otherwise the deputies) and for two years the system successfully delivered as one at the country level. However, the experiment soon unravelled. Almost from the outset, individual UN agencies lobbied hard with government representatives in New York to undermine UNDP’s primacy and allow them to establish their own representative offices. After only two years, unified offices had given way to the more unwieldy (and far more costly) country teams of separate organization representatives, which in some countries now number up to 20. In UN circles, unified offices were almost never spoken of again because of the dissension that they had caused. It boded ill for the most recent attempt at country coherence.

In 2006, the Secretary-General established a high-level panel on UN system-wide coherence. It was co-chaired by three serving prime ministers (Mozambique, Norway and Pakistan) and had three former or future heads of government (Chile, Tanzania, UK) as members. There were no representatives of the private sector or civil society, but the panel held consultations with non-governmental interests.

The panel called the UN’s work in development ‘often fragmented and weak’. Its governance and funding arrangements ‘contributed to policy incoherence, duplication and operational ineffectiveness across the system’. Furthermore, co-operation between organizations was ‘hindered by competition for funding, mission creep and by outdated business practices’ (United Nations 2007). During its deliberations some of the panel’s more innovative draft proposals were watered down under pressure from governments and UN agencies. For example, a group of 13 developed countries—most of the major donors to the UN development system—called for the closing of UNCTAD, but this was opposed by the developing countries (von Freiesleben 2008). However, even the more modest recommendations have had limited impact. The panel’s report, Delivering as One, contained 10 sets of recommendations, the first of which proposed a more unified and coherent UN structure at the country level (see Box 18.2). Given the experience (not acknowledged by the panel) with the fully unified offices in 1992–94, this was scarcely revolutionary. However, convergence in countries was one of the most actively pursued recommendations, even if it has fallen well behind its implementation targets. In terms of coherence, the impact has been limited, and enjoining different organizations to work together has often proved more costly in procedures and resources than parallel operations.

Recommendation 9 has also been implemented more comprehensively. By the end of 2010, the ‘UN Women’ organization had been established through a merger of four other programmes, and one of the panel members was asked to head it.

In a report weakened by compromise, two out of 10 is not a high score. Some of the other recommendations have been partially pursued, but there has been no progress towards creating a sustainable development board and a post of Development Coordinator, both of which were intended to help unify the system globally.

The timing of the report had been inauspicious. The report reached the General Assembly at a time of transition from a reformist to a much more cautious Secretary-General. Another
Table 18.2  Some examples of UNDS technical services

<table>
<thead>
<tr>
<th>Agency/Organization</th>
<th>Technical standards &amp; norms</th>
<th>Research, data, information</th>
<th>Intergovernmental co-operation, policy, conventions</th>
<th>Technical assistance</th>
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<tbody>
<tr>
<td>DESA</td>
<td>World population projections</td>
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<td>Public administration support</td>
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<td>UNODC</td>
<td>Narcotics production data</td>
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<td>Crop substitution</td>
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<td>UNDP</td>
<td>Regional, national human development Reports (from 1990)</td>
<td>Mekong River Commission (1960s–80s)</td>
<td>Electoral assistance</td>
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<tr>
<td>UNICEF</td>
<td>National child assessments</td>
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<td>Water and sanitation projects</td>
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<td>WFP</td>
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<td>Food for work schemes</td>
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<td>UNFPA</td>
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<td>Reproductive health measures</td>
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<tr>
<td>ITC</td>
<td></td>
<td>Export market data</td>
<td>Organic export promotion</td>
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<tr>
<td>UNEP</td>
<td>Climate change assessments</td>
<td>Montreal Protocol (1987)</td>
<td>Urban water supply</td>
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<td>Kyoto Protocol (1997)</td>
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<td>Stockholm Convention (2001)</td>
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<td>UN-HABITAT</td>
<td>Global urbanization data</td>
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<tr>
<td>UNAIDS</td>
<td>AIDS incidence monitoring (from 1990)</td>
<td>Support to national AIDS Commissions</td>
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<td></td>
<td>Annual regional surveys</td>
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<td>Support for regional institutions</td>
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<td>ILO</td>
<td>Labour standards</td>
<td>Global employment data</td>
<td>Migration policy</td>
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<tr>
<td>UNESCO</td>
<td>World Heritage sites</td>
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<td>Restoration of cultural sites</td>
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<tr>
<td>FAO</td>
<td>Codex Alimentarius (food safety)</td>
<td>Global agricultural statistics</td>
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<tr>
<td>WHO</td>
<td>Global health statistics</td>
<td>Avian flu, SARS containment</td>
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<td>UNIDO</td>
<td>Global industrial statistics</td>
<td></td>
<td>Support to Montreal Protocol compliance</td>
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The UN and global development

Table 18.2 (continued)

<table>
<thead>
<tr>
<th>Agency/Organization</th>
<th>Technical services</th>
<th>Technical services</th>
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<td></td>
<td>Technical standards &amp; norms</td>
<td>Research, data, information</td>
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<tr>
<td>IFAD</td>
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<tr>
<td>UNWTO</td>
<td></td>
<td>World tourism statistics</td>
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<tr>
<td>ICAO</td>
<td>Airline safety standards</td>
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<td>IMO</td>
<td>Maritime safety standards</td>
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<tr>
<td>ITU</td>
<td>Mobile communication standards</td>
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<td>UPU</td>
<td>International postal conventions</td>
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<tr>
<td>WMO</td>
<td>Support to Intergovernmental Panel on Climate Change (with UNEP)</td>
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<tr>
<td>WIPO</td>
<td>Intellectual protection</td>
<td></td>
</tr>
<tr>
<td>IAEA</td>
<td>Nuclear safety standards</td>
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Source: FUNDS project

obstacle was the conservatism of the UN Group of 77 (G-77) countries, whose official representatives in the UN have traditionally been suspicious of change and may indeed be the main impediments to UN system reform.

Successive reforms have done little to arrest the progressive fragmentation of the UNDS. Its continuing atomization is the first and most profound crisis. Having different parts of the same system working in duplicate and sometimes in opposition is not the best way of serving the cause of development in the name of the UN’s values and norms. A hard-nosed view of the present state of the UNDS would soon determine that there is considerable redundancy and wastage. More—certainly, as much—could be done with a lot less. However, the present governance system (or systems) of the UNDS is inimical to cost-effectiveness, dominated as it is by the long-standing and multi-limbed patronage of the developed country donors that influence the UN’s development agenda, and the interests of developing countries intent on maximizing the size of bureaucracies.

Substance

This brings us to the second challenge faced by UN development: of substance. How relevant are the activities of the UNDS? Notwithstanding its serious structural shortcomings, the importance of the UN in the development domain has often been authoritatively asserted (Commission on International Development 1969; Independent Commission on International
Development Issues 1980; Brandt 1983; South Commission 1990; Jolly et al. 2004; Jolly et al. 2009; Olav Stokke 2009). In each of its four main functions, the system can demonstrate achievements (Table 18.2). But there are a growing number of alternative mechanisms which call into question its uniqueness.

**Technical standards**

The UNDS continues to be an important source of technical standards. Whether it concerns the allocation of bandwidth (ITU), international postal conventions (UPU), maritime and air safety standards (IMO and ICAO), the tracing of nuclear materials (IAEA) or copyright (WIPO), there is a UN technical agency acting as custodian. In a more broadly developmental vein, the WHO is there to certify pharmaceutical drugs and set global health standards (such as safe air or water pollution levels); the ILO is the repository of labour standards; the FAO of the Codex Alimentarius, governing food safety.

The UNDS continues to play an important role where governments have the principal responsibility for establishing and maintaining standards. But where non-governmental actors are involved, it has no monopoly and there are alternative organizational mechanisms which also serve up widely accepted global norms. The International Organization for Standardization

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**Box 18.2 Recommendations of the High-Level Panel on UN System-wide Coherence**

1. Establishment of One United Nations at the country level, with one leader, one program, one budget and, where appropriate, one office (5 One UN pilots initially, 20 by 2009, 40 by 2012)
2. Establishment of a Sustainable Development Board to oversee the One UN country programs
3. Appointment of a Development Coordinator, with responsibility for the performance and accountability of UN development activities
4. Establishment of an independent task force to further eliminate duplication within the UN system and consolidate UN entities, where necessary
5. Establishment of a Millennium Development Goals funding mechanism to provide multi-year funding for the One UN country programmes as well as for agencies that are performing well
6. UN organizations committed to and demonstrating reform to receive full, multi-year core funding
7. Enhancement of UN role in responding to humanitarian disasters and emergencies (several proposals)
8. The UN Environment Programme to be upgraded and given real authority as the environmental policy pillar of the UN system (several proposals)
9. Establishment of one dynamic UN entity focused on gender equality and women’s empowerment
10. UN Secretary-General, World Bank president and IMF managing director to set up a process to review, update and conclude formal agreements on their respective roles and relations at the global and country levels.

Source: Secretary-General’s High-Level Panel on UN System-wide Coherence, Delivering as One, (New York: UN, 2007)
(ISO) develops and codifies industrial standards. It has antecedents which predate the UN’s creation, but it was not brought in as a specialized agency, and it has remained a mechanism of ‘voluntary consensus standard setting’ (Murphy and Yates 2009), involving governments, private sector and other non–governmental entities. Its voluntary consensus–building has worked well in other areas. From industrial nuts and bolts, ISO has successfully branched out to standards in work processes, quality management, environmental regulation and (most recently) corporate social responsibility. These standards have achieved wide recognition and have been realized in areas where cumbersome intergovernmental deliberations have fallen short. The growing importance—or more accurately the growing recognition of the importance—of the private sector in development inevitably encourages the widening of partnerships in standard–setting processes. Another modern example is seen in the role of the Internet Corporation for Assigned Names and Numbers (ICANN), a USA-based non–governmental organization (NGO) that took on the registration and management of domain names. ICANN has performed a useful role, and users have resisted the attempts by some governments to bring its activities under the auspices of ITU, perhaps recalling the difficulties that that organization had in organizing two World Summits on the Information Society with limited civil society participation.

Information, research and advocacy

An example of the UN’s authoritative role is in the estimation and projection of world population. Many organizations also publish annual surveys on the ‘state of’ their development domain (State of the World’s Children from UNICEF, State of the World’s Cities from UN-Habitat, World Health report from WHO, and so on). These and other publications such as the Human Development Reports of UNDP, are used as vehicles for advocating development approaches and restating key development goals.

In many areas of research and advocacy, there is also a growing number of alternatives to the UN. While the locus of development thinking was initially rooted in New York in the post-war period, it has steadily shifted to Washington and the Bretton Woods Institutions. In part, the shift has reflected the hegemony of neo-liberal thinking for which the World Bank and IMF were the main conduits, particularly from the 1980s. But, beyond the Washington Consensus, the World Bank has become a redoubtable centre of knowledge development on a much broader ideological basis. In parallel, many universities and independent research centres now undertake original and influential work. But while the UN has become more marginalized as a source of development thinking, there are still some research roles in which it can call upon its unique advantages of legitimacy. Two examples are of great contemporary relevance. One is the work of the Intergovernmental Panel on Climate Change and its periodic assessment reports which require both comprehensiveness and objectivity on a subject of planetry importance. Another example is the series of Arab Human Development Reports of 2002–04, which were the most influential (and most downloaded) studies ever produced by UNDP and which raised issues highly relevant to the upheavals of the 2011–12 Arab Spring. Both these examples demonstrate some areas where UN research, combined with advocacy, can have a critical influence on global debate, even if they cannot of themselves effect change.

Intergovernmental co-operation and conventions

In some critical areas such as environmental management, health and the social domain, the UN has been instrumental in fostering effective co–operation. Under UNEP auspices several
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key conventions were agreed, such as the Montreal Protocol on Substances that Deplete the Ozone Layer (1987), the Kyoto Protocol on Climate Change (1997) and the Stockholm Convention on Persistent Organic Pollutants (2001). Montreal came with a multilateral fund (MLF) and a strong commercial rationale and has been crucial to reducing the risk to the planet of ozone depletion. In the area of health, the UN (WHO, UNICEF and UNAIDS in particular) has conducted successful campaigns to eradicate or control diseases, either of a chronic sort (smallpox, polio, tuberculosis, malaria and HIV/AIDS) or occurring as epidemics (SARS, bird flu). In the social domain, the UN agreed to the Convention on the Elimination of All Forms of Discrimination Against Women (1979) and the most widely ratified agreement of all, the Convention on the Rights of the Child (1990). The various human rights conventions are also part of these idealist functions of UN co-operation.

But, while this third role of intergovernmental co-operation has seen some notably successful examples of crisis prevention and mitigation, in addressing more permanent global governance challenges the record has been mixed. In the early 1970s, the vibrant debate within the UN on a ‘new international economic order’ (NIEO) was around an ambitious and idealistic vision of a more equitable global economy (Bhagwati 1977; Murphy 1984). It was not the first, but turned out to be the last comprehensive debate within the UN on issues of global economic governance, and it is therefore instructive to examine the process and the content in a little detail.

The NIEO sought to redress imbalances of trade and international finance, and promised more generous flows of technology from North to South. The NIEO was sparked in part by the oil embargo imposed by the Organization of the Petroleum Exporting Countries (OPEC), following the Arab–Israeli conflict of 1973. Through the embargo, OPEC had demonstrated the power of commodity cartelization. Developing countries were in a large majority in the UN and had formed themselves into the ‘G-77’. The discussions led to a Declaration of the General Assembly in May 1974, containing radical language: ‘irreversible changes in the relationship of forces in the world necessitate the active, full and equal participation of the developing countries in the formulation and application of all decisions that concern the international community’ (UN 1974a).

Two key features of the resolution, affirmed in the December 1974 Charter of Economic Rights and Duties of States (UN 1974b), were commodity cartelization and the establishment of economic sovereignty by developing countries. The demands of these resolutions evoked a response from the North which called for another (seventh) Special Session of the UN General Assembly the following year. A more moderate resolution resulted. It endorsed most of the key provisions of the NIEO but, while it incorporated some of the language demanded by the North, it was accompanied by the written reservations of several developed country delegations.

The main sources of G-77 leverage were economic but, when it came to meaningful change, the results were paltry. Apart from oil, there were few critical commodities that could be effectively cartelized, thus limiting the countervailing power of developing countries. The United Nations Conference on Trade and Development (UNCTAD), created in 1964 as a forum for debate on global development issues, was mandated to negotiate agreements for commodities primarily produced by developing countries. The Integrated Programme of Commodities (IPC) and the accompanying Common Fund, however, did not come into existence until 1989, by which time a much more market-oriented development agenda was being driven by the developed countries. A prior achievement by UNCTAD was more significant. The Generalized System of Preferences (GSP) negotiated in 1968 gave developing countries easier access to developed country markets for some of their exports, although textiles and other products of particular importance were exempted. As the UN’s principal organization for economic debate, UNCTAD had its heyday in the 1960s and 1970s with the GSP and IPC, but it has since been eclipsed as a
meaningful forum. International trade discussions have moved to its neighbour, the World Trade Organization (Taylor and Smith 2007; Hoekman and Mavroidis 2007).

The NIEO was a demonstration of might-is-right in economic negotiation. The first resolutions were agreed under the duress of potential embargoes. But, when it came to implementation, the weaker partners lacked the leverage for meaningful change. Subsequently, in other areas of global negotiation, even the words have not been forthcoming. The inability to agree on common language is exemplified by the series of conferences of the parties (COPs) seeking agreement on the UN Framework Convention on Climate Change. Although national parliaments work on the basis of majorities (sometimes of two-thirds of the membership for important decisions), UN proceedings work on a consensus basis, effectively giving a veto to even the smallest states. As a result, on an issue as vital as climate change, member states do not feel under any duress if they find themselves in a minority. In spite of UNEP’s earlier successes with conventions on environmental protection, the prospects of reaching a meaningful binding agreement on climate change under UN auspices—especially if an effective mechanism could be devised to enforce compliance—are practically nil, prompting a growing number of experts to propose taking climate change negotiations out of the UN ambit. The machinations of the COP are just the most eloquent current example of why an alternative mode of international co-operation is needed to avoid UN-style intergovernmental gridlock. When in 2008 a financial meltdown threatened the Northern economies, the G-20 (Group of Twenty Finance Ministers and Central Bank Governors) meeting at head-of-government level agreed quickly on a programme of international stimulus. There was no initial recourse to the UN at all, highlighting the inadequacy of its slow consensual modus operandi.

Beyond the first stage of getting to ‘yes’ and finding meaningful consensus on an issue, there is the second stage of ensuring compliance with conventions, once agreed. The NIEO was largely ignored by the developed countries after agreement. In many other areas, the UN has produced conventions in substantial numbers, but their effectiveness depends on defining goals and ensuring compliance by member states. Ensuring compliance is an area of UN weakness. While the UNDS helps to draw attention to human needs, it is less effective in encouraging necessary policy change. Even where global conventions, such as those for women and children, build in monitoring mechanisms, the requirement for member states to report on compliance does not ensure that it occurs.

Perhaps the most important current example is the Millennium Declaration approved in September 2000 by the largest-ever gathering of heads of state and government. Much of the Declaration was based on the outcomes of previous global conferences convened by the UN during the 1990s. This background facilitated agreement on a comprehensive development agenda after only two days of deliberation. Unusually, the language of the Declaration was strong and explicit, but the laxity of compliance associated with UN declarations was one of the reasons that it was agreed with relative ease. Unfortunately, following the signing, and rather typically for the UN, nothing at all was done with the Declaration for several months. The UN secretariat clung to the sufficiency of language and initially failed to incorporate a progress-monitoring mechanism. When in the early part of 2001, the Millennium Development Goals (MDGs) extracted from the Declaration were agreed on and country reporting was considered, it was to be the governments themselves that would have the responsibility. But was this the best guarantee of successful achievement?

Reviewing MDG progress has been brought continually back to UN forums, which invariably on development issues polarize into sterile and anachronistic North–South confrontations. If this Manichaean configuration had some relevance during the NIEO debates, the subsequent major divergence in the fortunes of developing countries means that the G-77 membership
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now has perhaps only one thing in common: they can be solely defined as ‘aid receivers’. Thus UN debates—including the long series of global summits, which the UN continues to sponsor—have always resolved themselves into arguments about the sufficiency of aid. The MDG discussions are no exception, leading to the highly misleading notion that aid from the rich countries is a sine qua non of development success.

The relative ineffectiveness of the UN on matters of global co-operation can be attributed in large part to the cosiness of a too-friendly-to-fail governance system. Exclusive government representation is inevitable in what is putatively a global parliament, but Westphalian logic breaks down when a significant number of governments are judged to be unrepresentative, or maintaining limited military jurisdiction within their own territories, as in the case of some fragile states. The ‘third UN’ (Weiss et al. 2009) comprising non-governmental interests needs to be invoked, and nowhere is this more important than in the development arena. When it comes to the MDGs, the intended beneficiaries are better placed than governments to judge progress. To ensure their greater involvement—even just cognizance—the most useful thing that the (second) UN could have done following the Millennium Declaration would have been to translate and disseminate it widely around the world. If this was ever considered, it never happened.

The third UN is also insufficiently represented in the UN’s other cooperation initiatives. While states have retreated from their roles as once-dominant producers and traders in many developing countries, the role of the private sector in development has not commensurately been recognized. The UN has sought to bring business interests into discussions in areas such as energy and the environment, for example, through the formation of joint commissions and panels, and through side-events at global conferences. But the findings and recommendations of such bodies always need to come back for endorsement to the UN’s intergovernmental forums where, in the interests of consensus, outcomes are invariably whittled down to resolutions that pander to caution and conservatism. In the most recent global Conference on Sustainable Development (Rio+20), non-governmental and private sector representation was strong in side-events that generated many original proposals. However, the outcome document was widely considered an inadequate basis for addressing the most urgent environmental management issues.

Technical assistance (TA)

As noted above, the UN’s role in TA also dates from the early days of the UN. EPTA was established initially with the support of the USA, but it grew with contributions from other developed country governments, which overcame their initial reluctance to channel funds through a system that diluted control over the destinations of aid. There were early efforts by the UN to encourage full or partial cost-sharing with the beneficiary countries, but these efforts were actually opposed by some of the developed countries (Bleloch 1958), and a donor-dominated system of patronage emerged in which the rich countries exerted their influence over the system. The influence has been manifested in various ways: through dominance of the discussions of TA in UNDS governance bodies, through the reserving of senior positions in UN management and, to a growing degree, through the earmarking of donations by purpose and destination. Developed countries also sanction individual organizations by withdrawing from them. In 2012, the UK withdrew from UNIDO, on the grounds that it ‘does not play a critical role in the delivery of [UK] development objectives’ (DFID 2011, 200).

Earmarked (non-core) contributions to the UNDS have grown significantly, while core funding has stagnated. Non-core funding represented 70% of total contributions to UN
development in 2010 (UN 2012). Thus, far from embracing the principles of multilateralism, the UN’s most widespread and most visible form of assistance has increasingly become an adjunct of bilateral aid, following the agendas of donors rather than more objective perceptions of development needs. Perhaps the most extreme contemporary example of donor funding hegemony is the Spanish MDG Achievement Fund agreed in 2006. It is worth a total of US $700m., channelled through the UNDS, but destined only for the 59 countries of interest to Spanish bilateral aid, and individual projects have to be approved jointly by the UN and the Spanish government.

Another growing source of TA funding through the UNDS is from other global multilateral funds, which have emerged over the last two decades. The Multilateral Fund (MLF) of the Montreal Protocol, mentioned above, channels funds principally through UNIDO, UNDP, UNEP and the World Bank. The Global Environment Facility (GEF), created in 1992, was originally an initiative of the World Bank. But it was prized from the Bank’s control by the developing countries. UNDP had hoped to manage the GEF, but when this did not find favor with the donors, a compromise was found and a separate Washington-based secretariat established. Initially, all GEF funding was channelled through the World Bank, UNDP and UNEP, but the number of recipients has since been broadened to include other organizations, both within and outside the UNDS.

In the last decade, major new multilateral funds have emerged in the field of health, and today there are estimated to be as many as 90, if research and advocacy organizations are included (Isenman and Shakow 2010). Another new multi-billion-dollar source of health assistance outside the UNDS is the Global Fund to fight AIDS, Tuberculosis and Malaria (the ‘Global Fund’, GF). The creation of a huge health fund had been mooted by WHO in 1999, but was not given to the UN (WHO or UNAIDS) to administer (nor to the World Bank, which had been the original preference of the donors).

The MLF, GEF, GAVI and GF are all substantial funds managed separately (and governed differently) from the UNDS, thus continuing the proliferation of the multilateral system. All four sources continue to channel funds through different parts of the UNDS which, as a primary (as opposed to a secondary) source, now accounts for a much diminished share (16%) of total multilateral assistance, as compared with 29% in 1970.

UNDP and other organizations also actively solicit support from foundations and private sources, such as the Gates Foundation, even at the risk of distorting their formal mandates. As Bill Gates has commented on the UN’s three food agricultural agencies in Rome (FAO, WFP and IFAD), ‘they have taken on projects that weren’t strategic because they needed any funding they could get simply to stay in business’ (Financial Times 2012). Although a donor, Gates and others have explicitly stated their resistance to establishing new mechanisms within the UNDS because of concerns about the sloth of UN bureaucracy and inadequate transparency.

The UNDS has been able to sustain and increase the volume of its TA because of growing earmarked contributions from the rich country donors and from other multilateral organizations—whatever the price in terms of the sanctity of mandates. The single largest donor to the UNDS today is the European Commission (EC) (and its agencies). But since the EC is itself a multilateral agency, supported by most of the major donor countries, the funding is at second-hand, and is channelled through the UNDS for implementation purposes. Thus, whether the funding is bilateral or multilateral, the UNDS has increasingly become the tool of other donors, greatly enhancing the patronage function that was built into the system from the outset, and further diluting the principles of multilateralism. It is particularly in this fourth function of TA that the UNDS has become marginalized and where any UN hallmark is least visible.

The UN and global development
Facing the future

As we saw, the UNDS has had limited success in promoting greater coherence within a highly atomized structure. And its continuing relevance is threatened by its slow adaptation to the most important global challenges and by the growing number of alternative mechanisms of development co-operation.

A third challenge is the UN’s own failure to recognize adequately its own marginalization in the development domain. The urgency of reform has been substantially blunted by the continued flow of operational funds through the UNDS organizations from traditional bilateral and new multilateral sources. The system has become an adjunct of aid patronage— and thus not subject to rigorous cost-benefit criteria—rather than an objective purveyor of human development values. In several key domains, including economic governance, food security and energy, the UN has yielded the stage to other players, some of them created specifically in response to the UN’s own shortcomings.

What of the future? The world still needs a UN active in development, but what should be its future configuration, and how will change come? Leaving aside for the moment the latter question, we can begin to address the former by reference to a recent global perceptions survey of the UNDS (Browne and Weiss 2012), designed to assess the opinions of the global public on the need for a UNDS. The 2012 survey was part of the Future of the UN Development System (FUNDS) project of the Ralph Bunche Institute for International Studies in New York. It had 3,345 responses from all major regions of the world and across occupational groups encompassing the First, Second and Third UNs (the latter comprising mainly NGOs, private sector and academia). Most respondents were knowledgeable about the UN, and nearly one-third had at some time worked in or with the UN. It was one of the largest global enquiries on the UNDS in recent years and was designed and conducted by Dalberg Research, a Copenhagen-based public opinion consultancy with substantial experience working with the United Nations.

The following three figures are representative of the survey findings. On organizational matters, respondents were asked to list the changes that they felt were important for the UNDS in the medium-term (Figure 18.2).

Interestingly, the strength of opinion for change was stronger among those from developing countries than from developed. The five important changes that stood out were simplifying business procedures (i.e. less bureaucracy); expanding partnerships, including with the private sector; defining the respective roles of the UN, World Bank and IMF at country level; merging organizations in similar fields; and increased funding from non-traditional donors.

There were widely differing perceptions about the relevance of the different organizations of the UNDS in facing contemporary development challenges (Figure 18.3). From all groups, North and South, the two most favoured organizations were WHO and UNICEF, which seemed most closely to embody the human development vocation of the UN. At the other end of the scale were the five regional commissions which, with the possible exception of ECLAC, which has made its name as a thought-leader in Latin America, have never discovered distinctive roles, except as regional outposts of the system.

The assessment of the domains in which the UN is considered the most and least effective is also revealing (Figure 18.4). Overall, there is a minority of the 20 domains in which the UN is considered more, rather than less effective. The ‘softer’ social areas of health, human rights, education and gender tend to find more favour, while economic management, services and tourism, drug control and transportation are judged to be ineffective areas for the UN. There are not marked differences between respondents in the North and South. Respondents in developed countries consider that the UN is relatively more effective in poverty reduction, water and sanitation, social policy and governance, while those in developing countries consider the

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UN to be relatively more effective in international trade, and information and communications. Industry and economic management also score better, but are below the 50% effectiveness level.

The survey does not provide a blueprint for a reformed UNDS. However, it contains useful feedback on the expectations of the global public about the appropriate role of the UN in development. (And, interestingly, the representatives of governments and secretariats provided some of the more radical views.) Respondents are looking for a more compact and better streamlined system; other feedback calls for single UN representatives and programmes at country level, and a single head of the UNDS. A review of the domains in which the UN is active is also needed, with a concentration on human, as opposed to economic, development.

Given the consistent diagnosis of the system’s weaknesses over several decades, but the inability of the UN’s formal intergovernmental bodies to approve more than marginal changes, it is questionable how reform may come about. The current Secretary-General has proposed a Five Year Action Agenda coterminous with his second term, but it deals mainly with the internal practices in the secretariat, and even the permanent missions in New York are urging a bolder approach. In parallel, many of the organizations and specialized agencies are undertaking their own reforms, but each in isolation. A holistic plan for recasting the system as a whole is needed, but none has emerged since the 2006 Delivering as One report. A full-fledged funding
crisis would catalyse change, but even in straitened times and with the trimming of contributions, the developed countries have shown no signs of unwinding the patronage of their favoured UN organizations. The third UN, well represented in the 2012 survey, could help to stimulate change, but that would require an aggressive campaign to mobilize opinion in favour of reform. The likelihood, however, is that change will come slowly, if at all. What could impel reform? While the UNDS is not a very effective means of development support, sharing many of the same shortcomings of

Figure 18.3 Relevance of UNDS organizations for today’s development problems
Source: FUNDS Survey 2012
development co-operation in general, it does more good than harm and, at the cost of some US $15,000m. per year it is not especially expensive. Its funds support large numbers of development professionals from every country of the world, while also generating many contracts for NGOs and the private sector. If from anywhere, the clamour for change will most likely come from growing concerns about fragile and recovering states where recourse to the UN is often inevitable, and where development resources are necessarily combined with the three other pillars of the UN—peace-keeping, human rights and justice, and humanitarian relief—which combine an indispensable UN mandate with, for the most part, greater effectiveness.

**Conclusions: players, power and paradigms in UN development**

**Players**

The UN is the world’s only universal organization of nation-states. The conditions for membership consist of adherence to the Charter and approval by the General Assembly on the
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recommendations of the Security Council. In practice, membership is determined by sovereignty, although states can be debarred on the grounds of alleged democratic legitimacy, as occurred with mainland China until 1971, and Cambodia (then Democratic Kampuchea) during its civil war. (Sovereign Switzerland chose to stay outside until 2002, as long as membership was rejected by national referenda).

The UN’s membership has grown from 51 states in 1945 to 193 today. This growth represents not just a huge numerical change, but also signifies transformation from a body dominated by developed countries to one in which they are a small minority. In TA, however, where the purse-strings are held by the developed countries, this minority exerts disproportionate influence on the content and direction of a significant part of the UN’s resources.

There is also little homogeneity in the status of individual member states, with wide variations in their political legitimacy, if judged by democratic standards. The implications for the development arena are quite critical, since there are governments of developing countries for which the development well-being of their peoples are of secondary (even marginal) importance. These have been described as ‘extractive’ (as opposed to inclusive) regimes (Acemoglu and Robinson 2012). Chronic failure of some governments to live up to the terms of the UN Charter was never taken into account in fashioning the organization, but these shortcomings have persistently undermined the value of the agreements and actions of the UN in the development context.

Decision-making in the UN is invariably brought back to intergovernmental fiat. Formally, the consensus of nation-states is the basis of UN legitimacy. But excluding consideration of the views and the actions of players outside governments also undermines the value of the UN as a force for change in development. Some governments are resistant to involving non-governmental or private sector actors in their deliberations, even though they are key drivers of development processes. The (second) UN should continue to seek ways of involving non-state actors.

**Power**

The implications of the membership profile bear differently on the four functions of UN development. In its technical standard-setting function, the consequences of the composition of the membership are neutral. The same goes for statistical compilation and analysis. However, in functional co-operation and the forging of conventions, initiatives are often driven by secretariats (the second UN), supported by developed countries. The vast plethora of agreements is indicative of the precious and unique role of the UN as a forum for the development of norms across the whole spectrum of global activity. But the sheer number of agreements is also redolent of the failure of the UN to put in place adequate mechanisms to ensure compliance. The ‘compliance gap’ has been described as having three facets: implementation, monitoring and enforcement (Weiss and Thakur 2010). Some agreements lack even an implementation plan, many are not monitored, and in few are there any mechanisms of enforcement. Until the UN encourages more public shaming, e.g. by NGOs, in highlighting non-compliance, and devises more incentives to back up enforcement, most agreements will continue to exist in name only. However, there are no straightforward solutions. One of the more elaborate incentive systems devised to encourage compliance with the Kyoto Protocol was emissions trading (of the rights to pollute) and the Clean Development Mechanism, both intended to reward energy efficiency. But the results have fallen short of expectations, and in any case the world’s major emitters of climate-altering substances have remained outside Kyoto.
In economic governance, the UN was a focus of debate until the early 1970s, with the New International Economic Order debate. Substantially altering the balance of global economic power then would have involved the voluntary submission by rich countries to international controls on investment and trade, which they were unwilling, and under no duress, to accede to. In the contemporary world, where the emergence of major Southern economies has vested them with countervailing powers, multi-polarity offers more opportunities for a rebalancing. But the debate has moved out of the UN and into other arenas like the G-20 and the World Economic Forum. The universal, consensual basis for UN decision-making, while claimed as the basis of its legitimacy, is ponderous in practice. In the development domain, where urgent global solutions are often sought, the slow pace of the UN renders it ineffective.

The UNDS’s major function of TA is distorted by donor hegemony in setting agendas and steering resources, in spite of early attempts by the UN to encourage developing countries to articulate their needs through country programming (and encourage them to pay for TA services). Donor domination has increased as core resources have stagnated and the UNDS has become even more dependent on earmarked funds.

Paradigms

Is there a paradigm of UN development? Intuitively the answer is affirmative and it is empirically illustrated by the results of the 2012 FUNDS survey. The natural place for UN development support through TA is in health and education and the social sectors, which accords with the global public’s association of the UN with human well-being. The most comprehensive attempt by the UN to articulate a paradigm was the succession of UNDP’s Human Development Reports (HDRs), beginning in 1990, based on the simple but powerful idea of enlarging individual choice, and measured by a human development index:

the process of development should create a conducive environment for people, individually and collectively, to develop their full potential and to have a reasonable chance of leading productive and creative lives in accord with their needs and interests … development must be more than just the expansion of income and wealth. Its focus must be people.

(UNDP 1990, 1)

Thus defined, human development (HD) was, at the time, a key counterpoint to the economic development paradigm epitomized by the Bretton Woods institutions. But no New York consensus emerged. In 1994, the Secretary General produced an Agenda for Development (UN 1994) which made no mention at all of human development. The following year, when the sixth HDR was published, the UN’s Summit in Copenhagen was on social development, with no nod to the broader human concept in the outcome document. The UNDP paradigm had not crossed First Avenue and would never do so. Indeed, it remained largely in offshore isolation from UNDP’s own operations, even after the organization began sponsoring regional and national HDRs (Browne 2011). Human development was a parallel intellectual stream in an organization that was wedded to pragmatic operations. This, in spite of the fact that the series of Arab HDRs beginning in 2002 was the most widely read and most influential publication ever produced by UNDP, anticipating by several years many of the issues which brought on the Arab spring of 2011.

Other organizations of the UNDS have sought to define development in their own terms, but none has produced an original, path-breaking and quintessentially UN paradigm like...
human development. The fate of the paradigm is also a reflection of the inherent weaknesses of the UNDS. Human development (HD) was considered a UNDP brand and, given the sense of interorganizational rivalry, fragmentation and poor communications, and in the absence of a UN-wide knowledge management system, it never filtered out to the rest of the system. Nor has there ever been a single authoritative head of the system to ensure greater UNDS coherence in policy and substance.

Thus, players, power and paradigm all point up weaknesses of legitimacy, efficiency and relevance in UN development. Of the four UN pillars, it is the weakest and most marginalized. As successive attempts at reform have amply demonstrated, however, the system is impervious to radical change. The patronage that flows to and from the governments that dominate the UNDS make it affordable, and too friendly to fail. Even concerns of cost-effectiveness are overridden by the desire for continuity. Largely in consequence, the UN development system is becoming increasingly marginalized as a development partner for the majority of developing countries. If it is to remain the best means of addressing some of the causes of global fragility and assisting in the recovery of fragile states, the search for a better-honed, more cohesive and coherent, more flexible, more responsive and effective system must continue.

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Global economic governance and the regional development banks

Jonathan R. Strand

Introduction

The regional development banks (RDBs) are a diverse set of global institutions, varying in membership, size and function. The RDBs engage in development lending and provide policy advice for their members. Generally speaking, the RDBs share a common ideational grounding in neo-liberal economic theory regarding the ‘correct’ and ‘legitimate’ development policies that governments should pursue. However, the RDBs are less doctrinaire than the World Bank and International Monetary Fund (IMF) in the application of neo-liberal ideas. RDBs also are informed by a basic assumption in modern economic growth theory that a major impediment to economic growth in developing economies is the lack of capital. One goal, then, of RDBs is to facilitate the flow of capital into developing economies with particular attention on financing projects that may not be viable if only private sector options were available. Most RDBs are creatures of the Cold War and thus have experienced the vacillations of history as both material and ideational power relations have evolved over the past 50 years.

As formal intergovernmental institutions, the RDBs were created by and are managed by governments through the establishment of large bureaucracies. While they are examples of formal governance, the RDBs are not immune to the influence of ideas, norms, and practices associated with less formal modalities of global economic governance. The RDBs examined in this chapter have a regional character, yet this should not distract us from the global aspects of their operations, especially in regard to the member governments and the role of prevailing economic ideas. For instance, the Asian Development Bank has operations concentrated in Asia, but its membership includes non-regional governments such as the USA, Germany and France. Additionally, ideas about how to foster long-term economic development vary only by degree, not by kind, across the RDBs. In this sense the RDBs are agents of globalization in much the same way as the World Bank and International Monetary Fund (Woods 2006).

The RDBs are often compared with the World Bank for several obvious reasons. First, the World Bank is the paramount development organization in the world economy, and the RDBs are viewed by some as ‘mini’ World Banks. Such a claim can be misleading, as it glosses over differences between the RDBs and the World Bank, and differences across RDBs. A second reason for the comparison to the World Bank is structural. The internal governance systems of
the RDBs have many similarities to that of the World Bank (and IMF). The RDBs and the World Bank, for example, use weighted voting to apportion formal influence. However, there are key differences in the governance systems that make the RDBs interesting subjects for scholars concerned with institutional isomorphism. Most strikingly, the RDBs have rules in place to maintain the ‘regional’ characteristics of the institutions. The Inter-American Development Bank, for example, requires that at least 50% of all votes be held by regional, developing countries. In other words, the RDBs are not miniature World Banks; they are regionally focused development institutions that provide special roles for the regional members that draw on resources. Lastly, and perhaps most importantly, while grounded in neo-liberal economic theory, the RDBs have lending operations and doctrines that can differ from the World Bank.

RDBs are similar in their regionally focused missions and have fairly similar internal governance systems. The RDBs are rules-based institutions designed to promote economic development through lending, technical assistance and policy advice. Like all global institutions, the RDBs have gone through various transformations over the years. For example, when the African Development Bank was first created it excluded developed countries from its decision-making processes and it was not until the early 1980s that developed countries were able to become full members of the bank. Each RDB was created within a particular historical context and each has responded to shifts in global power relations, such as Japan’s rapid economic rise in the 1960s and 1970s, the end of the Cold War, the deepening of integration in Europe and the 2007–08 global financial meltdown. In order to isolate and explain primary factors in how RDBs have responded to changing norms and rising influence of new actors, it is useful to centre on the three Ps of governance: players, power and paradigms.

This chapter examines the place of the RDBs in global economic governance by considering the key players, power, and paradigms. The next section describes the historical contexts of the major RDBs and explains their place in global economic governance. Following this, attention is given to the internal governance of the RDBs to explore the formal rules used to determine the policies and lending practices of the RDBs. Section four addresses the role that the bureaucracies play. Next, ideational aspects of the RDBs are surveyed, with emphasis on the codification of good governance and the creation of accountability agencies. The conclusion briefly reflects on the response of each bank to the 2007–08 financial crisis in the context of an evolving world political economy.

**Overview and brief history of the RDBs**

A regional development bank is a multilateral development institution that engages in lending and other activities to foster economic growth in developing countries. There are four major RDBs. The World Bank is the most studied multilateral development bank and has been described as sitting in the ‘catbird’s’ seat atop the field of international development (Marshall 2008). The RDBs are smaller than the World Bank in terms of membership, geographic scope and capitalization, which partially explains why they are studied less frequently than the World Bank. The RDBs differ from the World Bank in ways that make them interesting, if understudied, subjects.

The highest profile RDBs are the African Development Bank (AfDB), Asian Development Bank (AsDB), Inter-American Development Bank (IDB), and the European Bank for Reconstruction and Development (EBRD). The first three were created during the Cold War, while the EBRD was created in the wake of the Cold War. The IDB was the first of the RDBs to be created. Figure 19.1 shows all new projects—i.e., loans, grants, and guarantees—approved in billions of US dollars from 2004–11 by these four RDBs.
The IDB began operations in 1959 and currently has 48 member governments. The IDB is headquartered in Washington, DC and has operations throughout the Western hemisphere. The IDB has two membership categories: regional and non-regional members. To be a regional member a government has to belong to the Organization of American States. Several European countries, Israel and Japan are among the non-regional members. The most recent member of the bank is the People’s Republic of China, which joined as a full, non-regional member in 2009. Since 2000, the IDB has added several new areas of emphasis in the making of loans and provision of policy advice. These areas include sectoral strategies to address such diverse topics as climate change, regional integration, food security and inequality (IDB 2011).

The AfDB was created in 1964 and was not created by wealthy governments such as the USA. Instead, the AfDB was born out of a political movement aiming to promote solidarity and co-operation among African countries. Many of these countries were newly independent and either circumspect of other multilateral lenders, unable to qualify for assistance from such lenders, or both. The AfDB, therefore, was meant to be a development bank controlled by and operated for the interests of African governments. However, one quandary facing the AfDB was the fact that the bank did not have direct access to capital from wealthy governments and was undercapitalized in the early years, since the member governments themselves had limited resources to assign to a multilateral bank. Eventually the AfDB became more of a global institution by allowing non-regional governments to join. Today, the AfDB is headquartered in Tunis, Tunisia and has 77 members, including 24 non-regional countries.

The AsDB was formed in December 1965 and began operations in 1966. The AsDB is headquartered in Manila and approved its first loan (to Thailand) in January 1968. Currently there are 48 regional members and 19 non-regional members in the AsDB. Of the four major RDBs, the AsDB has the most diverse membership, ranging from microstates in the South Pacific to the huge emerging markets of India and China, as well as developed economies such as the USA, Japan and 17 European countries. Japan plays a special role in the AsDB, where it

![Figure 19.1 RDB annual projects approved (US $000m.)](source: Annual Reports for each RDB.)
The regional development banks

has been the largest vote holder (along with the USA) and has had significant influence over staff. In 2008 the AsDB codified a long-term vision called Strategy 2020, which was designed to guide the AsDB in its lending and policy advice. Strategy 2020 defines several areas that the bank will focus on, including education reforms, environmental protection and regional co-operation (AsDB 2008).

The last of the RDBs to be established, the EBRD, was created in 1991 during the turmoil at the end of the Cold War. This RDB has several key differences from the others. For example, the EBRD has an explicitly political agenda, while the others officially downplay the role of politics in the approval and operation of loan projects. Not surprisingly, given the desire by many in Western Europe to ease the transition of Central and Eastern European economies after the failure of Soviet-supported regimes, the EBRD has as one of its key provisions the promotion of democratic institutions. The EBRD is also unique among RDBs in that other European institutions are members of the bank. With headquarters in London, today over 60 governments, the European Investment Bank and the European Union are members of the EBRD.

While these four multilateral development banks are the most widely known and studied, it is worth noting that there are smaller institutions operating at a subregional level or with very specialized missions that also engage in development lending. These include the Caribbean Development Bank (CDB), the Central American Bank for Economic Integration (CABEI), the East African Development Bank (EADB), and the West African Development Bank (BOAD). These specialized institutions have much more limited geographic scope and are also unique in that OECD countries are not members, although OECD members do provide some funding for projects. While they are less conspicuous than larger multilateral development banks, the relatively small size of these Subregional Development Banks (SDBs) can make them better equipped to grapple with local problems.

Related to the RDBs and SDBs, there are also multilateral financial institutions (MFIs) that engage in development lending. The highest profile MFIs are the International Fund for Agricultural Development (IFAD), Islamic Development Bank (IsDB), the Nordic Investment Bank (NIB) and the OPEC Fund for International Development (OPEC Fund). One obvious difference between MFIs and SDBs is that, where SDBs have easily defined geographic zones of operations, MFIs may or may not centre operations and membership in a particular geographic area. Most MFIs have very specific criteria for lending. The IsDB, for example, has a primary mandate ‘to foster economic development and social progress of its member countries and Muslim communities in non-member countries individually as well as jointly in accordance with the principles of Shari’ah (Islamic law)’ (IsDB 2012, 3). In order to comply with Shari’ah law the IsDB has had to be creative in the financial instruments that it uses to fund projects.

RDBs, SDBs and MFIs are important pieces of the global economic governance architecture, but often fly under the radar of scholars and policymakers since the World Bank is a much higher profile institution (Strand 2014). The next section examines the players and ideas that exercise influence within the RDBs.

Governments and the governance of the RDBs

RDBs are created by governments and have formal, legal arrangements that define and delimit the scope of their operations and how they are internally organized. Inter-governmental organizations differ greatly in the rules used to manage operations and to respond to a changing world political economy. A starting point for examining how the RDBs are governed is to consider formal rules found in their constitutional agreements. The RDBs have evolved
complex systems of weighted voting, selective representation and qualified majorities to determine how member governments are represented. This formal aspect of influence only captures one dimension of internal governance and a dimension that often is not the most important in the understanding of how RDBs are governed.

In addition to formal rules regarding how governments are represented, the RDBs have professional bureaucracies that have a profound consequence on how the organizations operate and implement the decisions made by member governments. Bureaucracies are often resistant to change and develop their own unique cultures. These features can undermine formal governance. On the question of who controls the RDBs, both the member governments and the staff need to be considered. The internal governance of RDBs is an important consideration, since the success of policies, lending projects and other external activities rests on perceptions of legitimacy of the organization. By examining the internal governance we can better understand which players exercise power.

The RDBs have two primary decision-making bodies, one comprising all members and another comprising a select set of members. By design the larger bodies are vested with ultimate authority and they usually defer most policymaking to the smaller body. The larger body usually is called the Board of Governors, which meets once or twice a year. These meetings are major events where high-ranking government officials confer with the Boards as well as the staffs of the RDBs. In the past 20 years, RDBs have also become more open to members of civil society during these annual meetings. While the meetings are high profile and important events, day-to-day decision-making and a lot of policymaking and negotiations occur under the auspices of a smaller body known as the Executive Board or Board of Directors.

It is within the Executive Boards that most loan decisions are made, as well as management of on-going activities with borrowing countries. Executive Boards meet once a week or more and work closely with staff members to prepare lending projects for consideration and provide oversight of projects previously approved. Selective representation in the RDBs is used to determine the make-up of the Executive Boards. For instance, on the IDB’s Board of Governors all 48 members of the IDB have a seat and voting rights. The IDB’s Executive Board has only 14 members. In order to select representatives for the Executive Boards, the RDBs aggregate most members into voting groups, which are sometimes called constituencies. Each voting group selects a member to represent the group on the Executive Board.

Some countries hold individual seats on the Executive Boards. In the IDB the USA and Canada are the only single-member seats; the other 46 members are grouped into 12 constituencies. Consider, for example, that Italy currently represents the members of its constituency in the IDB, comprising Belgium, Germany, Israel, Netherlands, Switzerland and China (PRC). Note that, in most RDBs, a constituency’s representative casts all the votes held by the members of the constituency, and these votes cannot be divided even in cases where members of the constituency have major disagreements. The advantage that selective representation offers is a reduction in the number of actors taking part in decision-making, which may increase the likelihood of agreement. However, an obvious downside is that a large number of members of the RDBs do not have direct representation with voting rights on the Executive Boards.

In addition to selective representation, RDBs rely on weighted voting to apportion influence. Weighted voting is a common method of assigning member governments varying amounts of influence within international institutions and is used by the IMF and World Bank. In the RDBs votes are assigned to reflect members’ relative shares of contributions to the banks. These relative shares are ostensibly meant to echo the relative positions of members in the world economy. In other words, countries with larger economies are expected to contribute

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more capital, and their voting shares will reflect their higher contributions. In theory, weighted voting is a useful means of recognizing that a one-country, one-vote method of influence—which we might expect from a juridical notion of sovereignty—is not practical when there are huge empirical differences in economic size. However, in practice weighted voting leaves a lot of room for political maneuvering as the determination of weighted votes is not a simple matter of feeding economic data into straightforward formulas to determine members’ relative shares of contributions. For instance, there are a variety of variables to choose from to determine relative size in the world economy. The choice of measures has a profound impact on determination of capital contributions and votes. Put differently, the determination of members’ votes is a political process involving negotiations between member governments.

A perception often articulated by critics of the RDBs is that weighted voting is a means for developed countries to control the RDBs, since wealthier countries obtain more votes. One way in which many multilateral economic institutions have attempted to overcome this perception is to assign some votes that are not based on economic size. Referred to as basic votes, these votes are assigned either as a set number or a relative share of a set percentage of all votes. The AfDB, for example, assigns each member 625 basic votes. The AsDB uses a different strategy as it provides each member with an equal share of 20 per cent of all votes. This proportional basic vote means that, as the total number of votes in the AsDB increases, the relative effect of basic votes remains constant. Notably, the EBRD does not use basic votes. Basic votes are meant to furnish smaller members, that otherwise would have only a handful of votes, with a voice in decision-making. The share of votes held by members of the RDBs, therefore, is a function of both basic votes and complex processes to assign weighted votes.

Another aspect of internal governance of the RDBs is the use of qualified majorities on certain types of decisions. Many decisions, such as most loan proposals, are decided using a simple majority of weighted votes. On more political issues, such as admitting a new member, suspending a member, or increasing capitalization, qualified majorities as high as two-thirds of all (weighted) votes are required. High-qualified majorities can make it easier for a few large vote holders to exercise blocking power. It should be clear that RDBs and their member governments spend a great deal of energy devising and implementing complex voting systems, but one paradox remains. Namely, the two major decision-making bodies rarely take formal votes. Instead of a formal vote, there is a norm that decisions are made by the ‘sense of the meeting’ to determine if a proposal passes or fails. There is a disconnection between the formality of determining voice (i.e. votes) and the making of decisions by what are ostensibly voting bodies. Lastly, when formal votes are taken they are often not recorded and not released to the public.

**Bureaucracies and the governance of the RDBs**

Member governments are key players in the RDBs, although not all governments have equal influence owing to the complex systems of internal governance. In addition to governments, the staff members that comprise the bureaucracies of the RDBs are influential. The bureaucracies can be divided between bank leadership and the rank-and-file staff.

Bureaucracies are important for a variety of reasons. Bureaucracies implement decisions made by member governments. The rank-and-file bureaucrats are relied on by the leadership to carry out bank policies, write assessments and other reports, and design loan packages. Bureaucracies are crucial since they have to operationalize the intent of leadership and member governments when they implement policies. This creates an opportunity for staff members to influence the outcomes of political decisions made at higher levels. Additionally, members of the bureaucracies are the faces of the institutions and reflect the institutions’ missions and internal
governance. Bureaucrats are hired based on certain characteristics and expectations about their technical training. For instance, economists hired by the RDBs are for the most part trained in doctoral programmes emphasizing neo-liberal economic theory; in other words, few if any Marxists are hired by institutions that value like-mindedness.

Consideration of the leadership in each RDB paints a scene reflecting the interests of member governments as well as the importance of certain ideas about development. The AsDB has 3,000 staff members, most of whom are from the Philippines. The majority of the Philippine national staff comprises of office workers and only a handful hold senior positions. Of the approximately 1,000 members of the bureaucracy who are not from the Philippines, Japan and the USA have the largest number, about 150 each, with the next largest contingent from India, with about 70 staffers. When we look at the leadership we find the AsDB has six management positions. As of 2011, these posts were held by nationals of China, India, Japan, Nepal, France and the USA. The presidency of the AsDB has always been held by a Japanese national who usually has close ties to Japan’s Ministry of Finance. In 2013, the AsDB’s long-standing President, Haruhiko Kuroda, was named Governor of the Bank of Japan. He was replaced at the AsDB by Takehiko Nakao who served as a Vice Minister in Japan’s Ministry of Finance. During this leadership transition there was almost no public debate or consideration of candidates other than Japanese nationals. There are four vice presidencies in the AsDB, one of which has always been held by an American. In addition, a sixth management position is the Managing Director.

The IDB has just under 2,000 staffers and most are stationed in Washington, DC. The president of the IDB has always been a national of a regional, borrowing country. However, several key positions have always been held by Americans, such as the post of executive vice president. The AfDB also has just under 2,000 staff members and its key management positions are with few exceptions always held by people from borrowing, regional member countries. The EBRD is the smallest of the RDBs in terms of number of staff members—about 1,500—with 10 key management positions. The EBRD’s leadership is probably the most diverse among the RDBs, with less emphasis on nationality.

The organizational culture of the RDBs has a profound influence on how each institution operates. Four aspects of the organizational cultures are worth exploring here. First, some observers assert the RDBs’ bureaucracies are risk adverse and, like the World Bank, exhibit an ‘approval culture’, whereby loans are approved simply to avoid conflict. Relatedly, controversial loans and projects that are opposed by major shareholders may be precluded from consideration. A second aspect of RDB organizational culture is the potential overemphasis on the nationality of management and staff. Has the president of the AsDB always been a Japanese national because he or she is the best possible person for the position or because of a norm whereby Japan gets more input into the selection of the president? The same question can be asked of other leadership positions. Third, the organizational cultures of the RDBs as well as their formal internal governance rules emphasize the role of regional member states. However, even with attention to the maintenance of a regional character, the RDBs remain grounded in economic ideas stemming from the prevailing, neo-liberal paradigm. Last, there is a path dependency, of sorts, that can lead to what one observer has labelled policy anachronism (Head 2005, 115). The RDBs, like other organizations, change slowly and can be insular from shifting norms and alterations in material power relations. The players exhibiting power within the RDBs are member governments with primacy in other forums of global economic governance (e.g. the Group of Twenty Finance Ministers and Central Bank Governors—G-20), as well as the bureaucracies with their own incentive structures. Together, these factors contribute to unique organizational cultures.

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These aspects of organizational culture point to the need for multivariate explanations of the behaviour of the RDBs. The RDBs have formal sets of rules that supposedly designate how decisions are made on loans and important policy matters. The role of the bureaucracies, including the leadership staffs, as well as the foundational ideas about development, also explains which players have power in specific contexts. Observers should not point to one aspect of RDB governance and behaviour, such as their weighted voting systems or nationalities of leadership, in order to understand the RDBs. The RDBs, as organizations, exist in an environment where they are subject to material pressures and ideational conflicts from global society as well as from within their own structures. The next section considers how changing ideas and power relations have become manifest in the RDBs, and how the RDBs have co-opted emergent ideas about accountability and 'good governance'.

Players, power and changing paradigms

Over the past six decades the number of RDBs and other development institutions has increased. There is now a complex set of organizations engaged in co-ordinating multilateral aid, providing policy advice and related activities. This trend toward deeper institutionalization is more than simply the increase in the number of global and regional institutions. Development aid as an issue area has grown to include numerous non-state actors as well as emerging economies whose governments have begun to provide capital for bilateral and multilateral aid. Governments such as those of South Korea, China, India and Brazil have become increasingly important foreign aid donors. One area where these new players have sought influence is within the multilateral development banks.

Multilateral development banks are often criticized by those on the political left for not doing enough to curb human rights abuses and for failing to promote socially progressive projects and domestic reforms. Observers on the political right often assert that these institutions contribute to unnatural risk-taking by governments (i.e. moral hazards). The AfDB, AsDB and IDB point out that their rules of internal management forbid the use of political considerations in making lending decisions. In short, these RDBs claim to be economic organizations, not political organizations. Dividing policymaking into political and economic domains requires them to adopt a double-speak, of sorts, whereby economic science becomes political science, and we are told that loans need to be tied to certain policy changes by borrowing governments not for political reasons, but for the pursuit of rigorous economic science.

What ideas about economy growth and development have been important in guiding the work of the RDBs? While some observers might be tempted to conclude that the RDBs follow the World Bank's lead regarding development ideas, this conclusion would gloss over variations in practices across the RDBs. While it is true that the RDBs engage in lending practices grounded in neo-liberal theories of economic growth and development, the regional character of these multilateral institutions results in a less than uniform adoption of the neo-liberal paradigm. In part this variation stems from attempts to maintain at least the perception that RDBs are more attentive to regional norms, values and players. Rules governing the allocation of votes to regional members, for instance, can be viewed as supporting the observation that regional members play a special role.

Various attempts have been made to identify unique, regionally inspired lending practices. Consider, for instance, the efforts by Japan to have multilateral institutions accept its post-World War II rapid rise in the world economy as an acceptable alternative for economic development. Japan and other East Asian economies engaged in state-centric economic growth strategies, which do not fit neatly into neo-liberal economic orthodoxy. Japan’s efforts resulted in a study
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produced by the World Bank that examined the development experiences of Japan, South Korea and other Asian economies (World Bank 1993). The AsDB published a related assessment that was even more supportive of the view that East Asian development was enhanced by government intervention (AsDB 1997). These and related reports on the ‘East Asian Miracle’ discussed how government intervention in the economy can foster development and were viewed by some as potentially challenging neo-liberal orthodoxy associated with development lending. However, the World Bank report fell far short of a blanket endorsement of the type of government intervention that many observers associate with East Asian development experiences (Wade 1996). The ideas associated with the East Asian Miracle report had only fleeting influence, as the East Asian Financial Crisis of 1997–99 led to several neo-liberal critiques of the development experiences of Asian economies; many of the criticisms relied on Paul Krugman’s explanation for East Asian development (Krugman 1994). In other words, despite pressure from Japan and other member states, there was little change to the overarching paradigm directing and informing lending operations of the AsDB.

Another example of doctrinal discord surrounds the AsDB’s Strategy 2020 report, which outlined several major goals for the bank. Under the leadership of AsDB President Kuroda, and with the support of Japan’s Ministry of Finance, this report was designed to provide the vision for the AsDB by setting a variety of goals related to its development mission. These goals include such issues as promoting regional integration and economic growth with an eye on sustainable development. Strategy 2020 also delineated several core values that include being responsive to the needs of members, adherence to the highest professional and ethical standards … outstanding leadership and service … commitment to partnerships with members of the international community … [and] accountability and focus on results by defining clear objectives’ (AsDB 2008, 22). Strategy 2020 sets new parameters for the AsDB’s loan projects and calls for half of all loans to involve the private sector.

As a major policy statement and an agenda-setting document, Strategy 2020 was not supported by the USA and other non-regional members. Civil society organizations voiced concern too; one asserted that Strategy 2020 has a clear ‘corporate bias’ (Bank Information Center 2008). There was political disagreement over the direction of the bank, with Japan and other regional members seeking ‘to strike out in new directions and help weld Asia together physically and in terms of policies’, while the USA and some European members wanted the AsDB ‘to stick to policies designed to reduce poverty and increase social well being’ (Rowley 2006). Italy’s representative voiced reservations about formulating a new vision for the bank, stating the AsDB ‘must remain firmly anchored to its vision of an Asia and Pacific region free from poverty. … All other strategic objectives must be pursued in ways that contribute to this goal’ (Carew 2006). In an unusually public display of discord, when Strategy 2020 came up for approval, the USA voted against its adoption (Minder 2008). The USA was the lone vote against the document, but others were also circumspect including poorer, borrowing members who were concerned about the shift away from traditional projects aimed at poverty reduction. Even with US resistance to Strategy 2020, one AsDB senior staff member claimed that there was no real impact on bank operations, with the implication that American opposition had only a nominal impact (Gopalakrishnan 2008, 11).

The RDBs have attempted to incorporate a regionally orientated accommodation of changing global norms while maintaining an overall emphasis on economic growth. The RDBs have had to balance their development mandates with a need to respond to external pressures. For instance, pressure from civil society groups as well as national legislatures has led each of the RDBs to formulate official policies regarding the protection and promotion of human rights. Additionally, the RDBs have taken the lead from the World Bank in developing standards to
assess good governance of domestic institutions (World Bank 1997). Good governance has many meanings, yet usually implies attention to transparency, accountability and adherence to rules (Doornbos 2001; Weiss 2000). The RDBs have created procedures to assess good governance. They have also created independent evaluation offices that are charged with various responsibilities including assessing the impacts of lending programmes and appraising how the institutions deal with complaints from a variety of stakeholders. Critics of the RDBs point out that these initiatives have not had a significant effect on moderating RDB behaviour. Indeed, some suggest that these new tools—good governance and evaluation offices—are little more than rhetorical responses to mollify critics. Much of the work on good governance has focused on the IMF and the World Bank, as the RDBs are generally viewed as more responsive to civil society organizations (Bøås and McNeill 2004).

In the AfDB, an effort has been made formally to assess the quality of domestic institutions in borrowing countries (Bøås 1998). The AfDB delineated its view on good governance in a 1999 report where it concluded that ‘good governance is an essential requisite for sustainable development’ (AfDB 1999, 17). To further address the issue, in the early 2000s the AfDB implemented Country Governance Profiles (CGP) that were designed systematically to evaluate each regional member’s domestic economy. CGP reports consider a variety of domestic institutions, with an emphasis on how domestic governance can influence the success or failure of development programmes. In a CGP report for Ethiopia, for example, the bank assessed a diverse set of domestic issues, such as electoral competition, corruption and gender empowerment. The report states that the AfDB’s direct support for good governance in Ethiopia has been delivered through policy based adjustment lending (AfDB 2009a, 15). In other words, good governance is promoted through conditional lending programmes.

As early as 1995, the AsDB orientated its focus on good governance toward public and corporate accountability, transparency and predictability (Root 1995). Adoption of good governance was not without political controversy in the AsDB (Rowley 1999). The bank focused on the accountability of government officials to their populations, with attention on how political leaders manage national economies. Ample public sector transparency is important according to the AsDB, because openness can decrease corruption and promote fairness in economic decision-making. The bank interprets predictability to mean regularized institutional processes as well as the rule of law. The bank asserts that these three dimensions of good governance need to be carefully balanced and has argued that, while ‘conceptually the three elements of [good] governance … tend to be mutually reinforcing, accountability is the ultimate safeguard of transparency and predictability’ (Root 1995). The AsDB’s early efforts on good governance have evolved from general statements about the role of accountability, transparency and predictability into regularized efforts to define and assess very specific aspects of good governance (e.g. AsDB 2000). In particular, the AsDB has concentrated its efforts on borrowing member countries and now produces reports and policy papers on the importance of good governance for effective economic development projects.

Given that the EBRD’s mandate involves reform of domestic political institutions, it is not surprising that the EBRD has expended considerable effort to address a variety of matters in the realm of good governance. The EBRD’s lending programmes are grounded in the view that economic reforms are intimately tied to political reforms; therefore, unlike the other RDBs, it is able to be more forthright in its political considerations. To this end, the bank engages in project and country assessments that review human rights, political institutions, rule of law, and other non-economic factors (EBRD 1993).

Of the four major RDBs the IDB has spent the least amount of energy on developing a coherent good governance agenda and instead has chosen to articulate specific frameworks on
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the topics of strengthening civil society, combating corruption and modernization of government institutions. The IDB treats its anti-corruption measures as part of a larger effort to promote transparency. For strengthening civil society, the bank has focused on the need for capacity-building. While not referring to the concept of good governance, the IDB delineates how it can support civil society and strong state institutions on the assumption that ‘[e]conomic reform and poverty reduction strategies will not be successful without strong institutions’ (IDB 1996, 3). Concern for governance issues are now integrated into IDB lending operations (IDB 2000).

Good governance has emerged as an important concept in the operations of the RDBs, although each has selected different aspects on which to focus. Good governance has become part and parcel of the ideas associated with the RDBs’ development paradigms. With the possible exception of the EBRD, when the RDBs were created the guiding ideas they operated under did not leave room for political concerns associated with good governance. There is not a lot of evidence that concerns about good governance have altered or improved RDB lending programmes and other activities. Attention to good governance has varied across the RDBs as the interactions of players and power impacts the adoption of new norms about governance. The emergence of good governance has also led to changes in how the RDBs self-assess their operations. In 2011 the AfDB published its first comprehensive self-assessment regarding whether or not it is significantly contributing to economic development in Africa (AfDB 2011). This report considers direct and indirect effects of AfDB lending as well as the bank’s management of its own operations, and largely concludes that the bank has been effective in almost all aspects of its operations. In sum, the RDBs, have attempted to regularize reviews of lending projects and other operations as well as create opportunities for claims of corruption to be investigated by quasi-independent agencies.

The RDBs have incorporated good governance in various forms into their day-to-day operations. Good governance as practiced by the RDBs is more focused on the domestic institutions of borrowers and less on their own internal governance and policies. Starting in the early 1990s the RDBs began to engage in more self-assessment as well as to construct formal bodies to review RDB activities. These new agencies, referred to as independent review bodies, are also equipped to investigate claims by stakeholders that they were harmed by a bank’s project. In 2008 the AfDB’s Independent Review Mechanism (IRM) started operations with a mandate ‘to provide people who are, or likely to be, adversely affected by a project financed by the Bank’ (AfDB 2010, 1). The IRM also engages in assessments of how well the bank observes its own standards through formal Compliance Reviews. While the IRM and Compliance Review processes allow for investigations of the effects of AfDB projects, there are two weaknesses. First, the processes are not fully independent of AfDB bureaucratic and leadership staff influence. Compliance Reviews are not regularized, and the IRM only initiates investigations if its (appointed) leadership agrees that there is a need for scrutiny. The second and more critical shortcoming is the lack of enforcement powers for the IRM. In other words, even if an investigation leads to a conclusion that the AfDB has harmed stakeholders or not fulfilled its own policy guidelines, the IRM cannot impose a remedy or alter AfDB projects.

The other RDBs have also created independent review bodies and procedures. In 2003 the AsDB implemented a new Accountability Mechanism (AM) designed to allow stakeholders to ask for a review of bank projects and assess how well the bank adheres to its own policies. The AM replaced the Inspection Function (IF) that the bank established in 1995, which fully investigated only a handful of cases. The IF was viewed by the bank as cumbersome for both claimants and bank staff. Like the AfDB and AsDB, the IDB has also adopted an inspection office called the Independent Investigation Mechanism (IIM). IIM is less formal than the AsDB’s AM or the AfDB’s IRM.
The adaptation of institutional policies illustrates how the RDBs have attempted to balance their development mandates with changing norms about the effects of their lending practices. The RDBs are grounded in the neo-liberal paradigm yet exhibit variations in the interpretation of specific aspects of the dominant paradigm. With the uncertainty resulting from the Great Recession and the increase in influence of emerging markets, the RDBs might diverge further from doctrinaire policies associated with neo-liberalism. The fact that China, India and other emerging economies are quickly becoming more important in the world economy, and in RDBs in particular, means that these players bring new found power to bear in the battle of ideas in the context of competing development paradigms. These dynamics raise the possibility that the changing power relations among players and ideas may result in modifications of RDB internal governance and lending practices.

Conclusion

The RDBs have made institutional adjustments reflecting changing power relations, changing players and the rise of new ideas. The drivers of change have been a set of complex factors such as evolving views about how governance practices can impact the effectiveness of development projects. The RDBs have also reacted to and co-opted ideas about maintaining accountability to their stakeholders. Good governance and accountability agencies emerged slowly and in reaction to internal and external pressures. The 2007–08 Great Recession required much faster policy adaptations, generating new challenges for the RDBs. How the RDBs responded to the Great Recession can inform us regarding institutional change in general as well as the abilities of the RDBs to perform under unusual circumstances.

The Great Recession can be viewed as the financial shockwaves that emanated from liquidity crises caused when the US housing market faced precipitous price declines, coupled with a loss of confidence in key credit markets. Multiple OECD economies experienced recessionary quarters at various points in 2008. Most strikingly, the core of this global crisis was centred in Europe and the USA, not, as in the case of the Latin American Debt Crisis and the Asian Financial Crisis, developing, non-OECD, economies. Even economies that did not formally enter recession experienced slowing rates of economic growth. The crisis led to a series of policy responses by OECD governments, the G-20 and global institutions like the IMF. Not surprisingly, the RDBs also responded to the crisis, primarily by infusing liquidity into distressed economies.

The IDB and AfDB’s responses to the crisis included the creation of new lending facilities. Both banks dedicated funds for emergency needs. The AfDB also increased the rate of disbursements for previously approved projects and sought to increase private investment. The AfDB established a quick response lending window: the Emergency Liquidity Facility (ELF). The ELF had an initial capitalization of US $1,500.m and was open to both governments and private financial institutions. In addition to swiftness of disbursements, the ELF ‘can be used to meet a broad range of obligations’ (AfDB 2009b, 4). The IDB also created a new lending facility called the Emergency Liquidity Fund with $6,000.m. in capitalization. This type of temporary lending window has been formed in the past by the IDB in response to natural disasters.

The EBRD’s primary response to the financial crisis is in the form of a co-ordinated effort with the IMF, World Bank, several European institutions and EU governments in the 2009 Vienna Initiative. This initiative predominantly has been an effort to support private banks, many of which face sizable portfolios of under-performing loans. In 2009 the EBRD also increased its lending by just over 20 per cent. The AsDB’s response involved increased
lending to the most affected economies as well as co-ordination of emergency lending with other institutions including the World Bank, IsDB and sovereign investment banks (AsDB 2009).

The RDBs play a crucial role in global economic governance as lenders, policy advisers and agents of neo-liberalism. The responses by the RDBs to the Great Recession highlight how they are committed to development lending as a solution to economic turmoil. The responses also demonstrate the close ties that RDBs have to other leading institutions and ideas guiding the dominant development agenda. The RDBs have been driven to reflect changing norms and power relations, such as in implementing good governance doctrines. At times these global institutions expose potential cleavages between major donors, such as over the AsDB’s Strategy 2020, and this raises prospects for further discord as emerging markets become more influential.

During the Great Recession the RDBs were part of the overarching solution pursued by central banks and multilateral lenders to support global capitalism through increased liquidity. Now that the immediate crisis has passed, the weaknesses of the dominant development paradigm exposed by the Great Recession may lead to policy debates over the road that the RDBs are to follow. Owing to the role that regional governments play in the RDBs, they are perhaps uniquely positioned to serve as inclusive forums for critical deliberations about development lending. Ultimately, the recent crisis has revealed that the RDBs remain organizations of lenders and borrowers employing a set of market-orientated policy responses restricted to lending programmes founded on a narrow array of economic ideas.

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The regional development banks


Non-DAC donors and the changing landscape of bilateral aid

Katherine Kitterman and Michael G. Findley

Introduction

Wealthy nations have allocated over US $5,230,000m. in development assistance to developing countries over the past 50 years, with bilateral aid accounting for approximately 43% (Tierney et al. 2011). While no single institutional framework encompasses all these bilateral donors, the Organisation for Economic Co-operation and Development’s (OECD’s) Development Assistance Committee (DAC) has functioned as the largest forum since 1961 (DAC 2012). The Committee facilitates agreements on standards for aid and development policy for its now 24 member states and monitors aid flows of members and other donors through the Creditor Reporting Service (CRS).

The DAC brings together donor government and multilateral institutions in order to improve aid effectiveness. It provides data on economic conditions and aid flows, conducts policy analysis and peer reviews of members’ aid programmes and facilitates decisions and recommendations on best practices in aid. The DAC has evolved considerably and, among other changes, has come to recognize the importance of a comprehensive approach that harmonizes aid between donor and recipient countries as well as among donors themselves. These changes are reflected in the OECD-driven high-level fora over the past decade—held in Rome, Paris, Accra and Busan—in which the OECD provided leadership in addressing pressing problems in foreign aid.

Although the DAC has been the primary institutional framework for the provision of development assistance, both established and newer non-DAC donors have grown in influence and, for some, have begun to pose a potential challenge to the traditional DAC approach. The changing landscape of bilateral aid reflects the global economy’s transition toward more decentralized influence from a host of players. As bilateral donors outside the DAC expand their funding and their reach, they offer alternative models and may introduce competitive pressures into the aid market. These donors’ increasing economic and political clout has led to greater involvement in the global aid governance dialogue, even as they remain outside established international aid structures. (Also see Büthe and Cheng, this volume, for a discussion of the increasing role of private actors in aid, transnational NGOs as aid channels, private foundations and venture philanthropy, and peer-to-peer development funding.)
Non-DAC donors and bilateral aid

This chapter describes basic patterns in aid allocation, with an emphasis on the differences between DAC and non-DAC donors, the key ‘players’ outlined in the framework chapter. While some non-DAC donors have had long-running aid programmes (e.g. some Arab countries), we mostly refer to non-DAC and newly emerging donors simply as non-DAC donors because they have only recently garnered any significant attention as foreign aid donors.

We consider differences between DAC and non-DAC donors over time (1973–2009), by region of recipient and by aid sector. These comparisons are based on project-level information from AidData (Tierney et al. 2011), which provides the most comprehensive database of aid flows both inside and outside the DAC. We then consider brief case illustrations of four non-DAC donors: Kuwait, Brazil, India and China. While Chinese aid is not publicly available, we include some initial findings from a recent initiative by the World Bank to code Chinese aid from public documents (Foster et al. 2009). These comparisons offer insights about the relative ‘power’, as outlined in the framework chapter, of these two sets of donors.

Taking stock of the differences between DAC and non-DAC bilateral aid is important because many observers have suggested that non-DAC donor aid may actually undermine development objectives (Naim 2007; Rowlands 2008). On the other hand, others claim that they compare favourably with DAC members on several fronts (Dreher et al. 2011; Woods 2008). The debate about whether non-DAC donors undermine DAC efforts speaks to the ‘paradigms’ dimension outlined in the framework in that each set of donors may have different priorities that may be more or less beneficial to recipient countries.

Notably, most studies of non-DAC donors up to this point have lacked the comparable data on both DAC and non-DAC aid flows necessary to pinpoint the differences between their aid models. As such, we attempt to identify factors that may differentiate DAC and non-DAC donors and discuss how development paradigms may or may not be changing. We conclude the chapter with a discussion of how examining non-DAC donors may shed light on development policy questions, as well as highlighting yet unanswered scholarly questions in need of further engagement.

Who are the non-DAC donors?

The recent rise of non-DAC donors actually constitutes their ‘re-emergence’ onto the global scene (Walz and Ramachandran 2010, 5). Kuwait began its aid fund in 1961, and countries such as Russia and India have also been providing development assistance in various forms for over 40 years. Other donors of course have only recently entered the scene, and thus justify the newly emerging donor label.

While non-DAC donors’ development programmes vary in age, intent and scope, they can be roughly grouped into a few categories, roughly consistent with those that Walz and Ramachandran (2010) identified: newer non-DAC donors, Arab countries and the Southern regional giants. The newer non-DAC donors include post-communist states such as Slovakia, Poland and Hungary, as well as Asian and Latin American donors such as Thailand, Colombia and Brazil. Most of these newest donors are still net aid recipients themselves; for these states, becoming donors may be one way to signal their increasing stability and their importance in the global economy. They generally target neighbouring countries in small project-level aid. This aid totals nearly US $170m. (2009 value), of which over 60% stays within each donor’s region (Tierney et al. 2011).

A second group of non-DAC donors includes such giants as China, India and Venezuela, which have the potential for the greatest influence on global development because of their growing economic and political clout. They also generate the most controversy because their
development models are the most different from accepted principles and practices. These donors stress mutual assistance and South–South co-operation, but they are cautious about fully joining the official international donor community. Maintaining independence means they are less likely to co-ordinate with other donors and are reluctant to report their aid. Since these states do not report aid, the estimates vary from US $1,500m. to $25,000m. (2009 values) for China, and between $1,000m. and $2,500m. for India and Venezuela (Walz and Ramachandran 2010, 2).

The Arab countries are the oldest donors that have remained outside the DAC, and their reported aid flows to the DAC’s Creditor Reporting Service (CRS) show a strong social solidarity. Although willing to co-operate on transparency issues, the major Arab donors channel little of their aid flows through multilateral organizations and protect their policy independence by maintaining separate aid structures such as the OPEC Fund for International Development. Arab aid tends to fluctuate with oil prices, but it makes up a larger percentage of the donors’ gross national income (GNI) than does aid from many DAC countries, and it totals at least US $69,400m. (2009 value) since 1973. Whereas Arab donors initially focused their aid within the Middle East, they now channel almost 44% of their aid toward African countries, with a further 26% remaining within their own region (Tierney et al. 2011).

The aid challenge and non-DAC donors

The increasing importance of non-DAC donors comes at a critical time for the DAC and the global governance of development. After decades of substantial official development assistance, many recipients may be no better off than they were 50 years ago (Doucouliagos and Paldam 2009; Easterly 2006). Poverty, hunger and disease have not been eradicated by projects and programmes, and in many instances they have become more complex and seemingly insurmountable challenges. This has tempered the legitimacy of North–South aid governance and highlights potential pitfalls of a programmatic, top-down approach that may weaken recipient ownership of the development process and jeopardize its effectiveness. One of the most prolific critics of the DAC model, a long-time economist at the World Bank, has identified several weaknesses including the absence of bottom-up feedback, the complicated processes of a bureaucratic approach to aid and donors’ tendency to measure effectiveness in terms such as volume of output rather than poverty reduction (Easterly 2006).

The lack of transparency in DAC aid has been a critical weakness and may contribute to the lack of aid effectiveness. Although both DAC and many non-DAC donors report aid flows to the CRS, they do so in different forms and often provide only vague or partial accounts of their activities on the ground. Without this information, donors may establish overlapping projects, which could overwhelm recipient capacities, and citizens could be less able to hold agencies accountable for the foreign provision of goods and services (Davies 2008; Kragelund 2008).

As donors more fully recognized this problem, they articulated goals at high-level meetings in Paris (2005) and Accra (2008) to establish more uniform and comprehensive reporting, but even established donors have been slow to implement these standards. This motivated the multi-stakeholder efforts of the International Aid Transparency Initiative (IATI) to encourage best practices in reporting and the adoption of a common data format to make aid information more useful to citizens and governments in developing countries (IATI 2013). Efforts such as IATI and AidData to create consistent and inclusive aid flow databases may result in better understandings of the landscape of foreign aid. But much remains to be done, especially the translation of aid information into better aid outcomes through co-ordination across donor types and with governments.

Due to an increasing awareness of these and other problems, the pressing questions in the aid community today are focused on measuring and improving aid effectiveness. Four high-level
donor fora since Rome (2003) ‘grew out of a need to understand why aid was not producing the development results everyone wanted to see and to step up efforts to meet the ambitious targets set by the Millennium Development Goals (MDGs)’ (OECD 2012). These meetings resulted in agreements outlining principles to maximize aid effectiveness. There is some evidence that donors are attempting to respond and provide more effectual aid. After research identified ‘good governance’ in recipient countries as a key to aid’s success (Burnside and Dollar 2000), DAC donors committed to a wide range of measures to direct their aid toward the states most likely to use it well. Examples such as the Millennium Challenge Corporation (MCC) suggest that donors have tried in some ways to respond.

As these standards have become more prominent and accepted, many turned their concerns to non-DAC donors. In particular, scholars and policymakers alike have expressed concerns about whether newer non-DAC donors will follow the new norms or undermine them in crucial ways. These concerns depend on some critical assumptions, however, most notably the profile of the non-DAC donors. Are these donors giving a significant amount of aid such that the donor community should be concerned? Do the patterns—regional and sectoral—differ enough from what the current community practises? Will non-DAC donors introduce pressure that motivates DAC donors to move toward or away from more effective and sustainable practices?

Many observers caution that non-DAC donors may undermine development aid’s fundamental objectives because their practices differ so significantly from DAC norms. They worry that if these donors’ aid does not meet the standards and practices developed by decades of DAC experience, it could undercut necessary reforms, pile new debt on ex-HIPC (heavily indebted poor country) states, and overwhelm recipient governments (Naim 2007; Manning 2006). Others argue that these fears are unfounded and that donors outside the DAC have better track records on some issues than those within it (Dreher et al. 2011; Kragelund 2008). Further, the donor competition that they introduce could extend aid flows to a broader range of states and sectors and give recipient countries greater ownership in the development process (Kragelund 2008; Woods 2008). Similarly, Büthe and Cheng (this volume) argue in their chapter that private actors’ shift in focus from humanitarian to development aid grew from a widespread perception that NGOs could be more flexible, efficient and innovative than government aid bureaucracies.

This increased choice in aid is growing more important as the traditional development assistance models face more scrutiny in the search for greater aid effectiveness (Rowlands 2008; Walz and Ramachandran 2010; Woods 2008; Easterly and Roodman 2004). Because of the shifting global economy and the declining legitimacy of DAC aid models, non-DAC donors are gaining a stronger voice in development communities (Arab Coordination Group Institutions and OECD Development Assistance Committee 2009). The partnership agreement at the 2011 Busan High Level Forum on Aid Effectiveness included China, India, Brazil, South Africa, the Arab states and many other non-DAC donors, for example, but did not actually bind them to its terms. This shows that these donors are increasingly able to exercise their growing economic and political clout to influence the development governance dialogue, even while maintaining their own independent aid models (Barder 2011).

The changing landscape of foreign aid?

We now turn to an examination of the basic patterns and differences in DAC and non-DAC provision of foreign aid. AidData includes project-level funding and sector information for over 866,700 bilateral aid projects between 1973 and 2009. The non-DAC donors included in
AidData are Brazil, Chile, Colombia, Estonia, Hungary, India, Republic of Korea, Kuwait, Latvia, Lithuania, Poland, Qatar, Saudi Arabia, Slovak Republic, South Africa, Thailand and the United Arab Emirates. Although AidData coverage for some of these donors is not complete, it represents the most comprehensive picture available as it includes aid flows reported to the DAC, the UN and other sources. Because the data on DAC donors is likely to be more accurate, any estimates of non-DAC donor aid most certainly under-report the relative share. Any conclusions thus need to be considered as the minimal role and effects of non-DAC donors.

Two of the most prominent non-DAC donors, China and Venezuela, do not report their aid to any organization, so they cannot be fully included in this analysis, though we consider China as a case illustration.

As Figure 20.1 shows, DAC members’ aid has always constituted the lion’s share of development assistance. But the overall share has fluctuated somewhat over time, including very little non-DAC aid granted in the early 2000s. Since that time, both DAC and non-DAC aid have been increasing substantially, but the relative shares still favour DAC donors by a substantial margin, at least based on available data.

Restricting the sample only to the last decade further underscores the point: there is a large increase in the share of non-DAC projects and aid. Non-DAC donors account for 4.1% of all foreign aid projects and 8.8% of the aid flows in the last five years of the database. From 2000–04, in contrast, they comprised only 0.2% of the projects and 3.4% of the share of aid flows (see Table 20.1).

### Aid by region

Comparing DAC and non-DAC donors’ regional aid allocation patterns highlights some key differences between the two groups’ geopolitical priorities. Non-DAC donors appear to direct
most of their aid toward neighbouring countries, so the largest share of their aid remains within
the region. The graph in Figure 20.2 illustrates that about one-third of DAC aid is allocated to
African recipient countries, whereas non-DAC donors give over 40% of their aid to Asia, with a
large share of that from the Republic of Korea. Compared to DAC donors, much less non-
DAC aid flows to Africa. South Africa is the only non-DAC donor on the continent and most
newer non-DAC donors have primarily concentrated on their neighbours within their respec-
tive regions. Fewer aid projects (and aid funds) from non-DAC donors are directed toward
South American recipients, moreover, while more are directed toward the Central Asian
republics and Central American states. Interestingly, much less non-DAC aid is reported to
‘unspecified’ recipients than aid from the DAC, perhaps somewhat due to the importance that
these non-DAC donors place on the prestige and political leverage to be gained from reports
of their aid.

Because non-DAC donors focus on their neighbours, they may compare less favourably with
DAC donors in targeting the poorest countries and regions with their aid. This confirms the
findings of Dreher et al.’s (2011) analysis and may lend some credence to claims that non-DAC

Table 20.1 Total aid, 2005–2009

<table>
<thead>
<tr>
<th>Total aid 2005–2009</th>
<th>DAC donors</th>
<th>Non-DAC donors</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projects</td>
<td>389,751 (95.9%)</td>
<td>16,886 (4.1%)</td>
<td>406,437</td>
</tr>
<tr>
<td>Total Aid (2009 US $m.)</td>
<td>$553,904 (91.2%)</td>
<td>$53,147 (8.8%)</td>
<td>$607,051</td>
</tr>
</tbody>
</table>

Figure 20.2 Comparing regional aid flows
Source: Tierney et al. 2011; data compiled from AidData.org
aid is driven more by strategic than by developmental concerns (Naim 2007; Rowlands 2008). However, these authors also found that the neighbourhood effect gave non-DAC donors a better track record than DAC members on lending to countries with good governance. As DAC members themselves struggle to reach effectiveness and governance allocation standards set at Paris and Accra, non-DAC donors may be lagging behind the trend rhetorically, but not in practice (Walz and Ramachandran 2010).

Turning to shares of aid within each region, Figure 20.3 indicates that non-DAC donors comprise a very small proportion—less than 10%—of development finance in any region of the world. Non-DAC donors provide almost 10% of the yearly aid flows to recipients in the Pacific Islands, but barely have a presence in the total aid packages of other regions, even those regions receiving the bulk of non-DAC aid. This may be due to the huge disparity in project size between DAC and non-DAC donors. DAC donors’ projects in European countries average US $2m., while non-DAC donors’ projects in the region average $64,000 (Tierney et al. 2011).

Because non-DAC aid is literally a drop in the bucket, concerns raised about counterproductive incentives and negative effects on governance are likely to be insignificant for most developing countries. Even for the countries receiving the largest shares of total aid from non-DAC aid flows, Cambodia (3.57%), Mongolia (3.53%), Philippines (3.48%) and Ukraine (3.08%), none receives more than 1% from any non-DAC donor besides the Republic of Korea. This hardly amounts to a preponderance of non-DAC influence in the market for aid. Instead, the relevant key differences with DAC donors lie in non-DAC donors’ overall focus on neighbours and in their more limited reach to developing countries. It is worth repeating that these conclusions rest on assumptions about comprehensiveness of data. And yet it is also hard to imagine that, if one were to complete the picture, non-DAC donors would comprise a drastically higher share of foreign aid in the world.

Figure 20.3 Donor allocations by region
Source: Tierney et al. 2011; data compiled from AidData.org
Non-DAC donors and bilateral aid

Aid by sector

Non-DAC and DAC donors’ sectoral allocation patterns are more similar than their regional ones, as shown in Figures 20.4 and 20.5, although several key differences remain. In both cases, the largest share of aid depicted is actually a collection of the smallest sectors. For DAC donors, 45.8% of their aid is allocated to water, social services, transportation, communications, energy, financial and business, industry, mining and construction, and trade and tourism. For non-DAC donors, these sectors make up 39% of the total. One of the key differences picked up in this combination of sectors is that non-DAC donors focus more on communications, transportation, industry and mining than do DAC donors.

The largest sectors depicted in Figure 20.4—government, education, health, agriculture and multisector—show some differences. The largest distinction lies in aid for education, which receives a full quarter of non-DAC aid flows, nearly double the 12.2% of DAC members’ (Figure 20.4). Conversely, they direct less funding toward programmes to strengthen government and civil society and on multisector projects, which are especially popular for DAC donors (Figure 20.5).

Non-DAC donors, on the other hand, have largely avoided commodity aid and budget support (Figure 20.5). Other researchers have found a similar paradox in governance standards for aid allocation, where non-DAC donors actually exhibit less of a tendency to aid corrupt countries than their DAC counterparts (Dreher et al. 2011). This contrast highlights DAC donors’ inconsistent track records, making non-DAC donors’ fresh money and fresh promises more attractive in the aid market (Woods 2008, 1220).

Continuing with an examination of Figure 20.5, non-DAC donors also tend to include proportionally more loans covering administrative costs than DAC donors, totalling over 20% of these projects. Still, just as with regional aid, non-DAC aid comprises only small portions of total aid in any sector and certainly does not dominate the market for any aid type.

Figure 20.4 Comparing sectoral aid flows
Source: Tierney et al. 2011; data compiled from AidData.org
Non-DAC donor illustrations

Individual donor countries’ aid practices vary significantly from this composite picture of non-DAC aid because each follows unique priorities in aid allocation. Some focus on unique sectors or regions, while others follow DAC allocation patterns more closely. More established non-DAC donors approve more and larger projects, while most newer non-DAC donors tend to deliver aid in many smaller projects within each recipient country. In the following four case illustrations, we provide a closer look at the aid models of four non-DAC donors: Kuwait, Brazil, India and China. These donors are, of course, not representative of all non-DAC donors but they offer some variation in order to provide some perspective on the diversity of non-DAC donor profiles.

Kuwait

The Kuwait Fund for Arab Economic Development, established in 1961, was the first aid organization financed solely by a developing country. Kuwait gave only to Arab countries until 1975, but now has a broad reach into more distant regions where need is most concentrated. More than one third of Kuwaiti aid is directed toward African recipients, while slightly less flows to the Middle East and approximately one sixth toward Asian countries. In their agreements with many African countries, Kuwait and the other Arab donors approximate DAC members’ reach more closely than other non-DAC donors. The types of projects that Kuwait funds, however, are quite different from DAC patterns or even the composite aid flows of non-DAC donors (see Figure 20.6).

With almost no allocation towards education (which is very unusual), almost a third of Kuwait’s aid funding has been directed toward transportation projects. Water, energy, industry and agriculture projects also comprise significant portions, which are relatively smaller categories.
Non-DAC donors and bilateral aid

Figure 20.6 Kuwait’s aid flows by sector
Source: Tierney et al. 2011; data compiled from AidData.org

for DAC donors. One other definitive characteristic of Kuwaiti aid is its volatility—Kuwaiti, and Arab aid more generally, tends to fluctuate with the price of oil.

Kuwait has played a key role in improving communication and co-operation, both among Arab donors and also between them and DAC member countries. Kuwait’s invitation led to the 1975 creation of the Arab Coordination Group, which has provided a forum for the directors of national and regional Arab funds to ‘optimize the application of resources’ by sharing information and co-ordinating efforts on larger projects (Arab Fund for Economic and Social Development 2012). Since 2009, the Coordination Group renewed a dialogue with the DAC that had been left off since the 1980s. These joint high-level meetings have focused on sharing knowledge and identifying opportunities for collaborating efforts in some partner countries, and have led to the Arab donors’ participation in the DAC’s Working Party on Aid Effectiveness. Kuwait’s participation in these dialogues indicates an acknowledgement of common objectives with the DAC in reaching the Millennium Development Goals, promoting sustainable development and supporting partner-country ownership of the development process.
Brazil

Brazil’s emerging aid programme has been called a ‘global model in waiting’ (The Economist, 2010). It is much larger than the Brazilian Cooperation Agency’s annual budget of US $30m. would suggest, as other Brazilian institutions provide a significant amount of technical assistance. Unlike most other non-DAC donors, but similar to DAC donors, Brazil directs the lion’s share of its aid outside the region, with almost half going to African recipients and less than 15% to South America. These allocation patterns more closely resemble the wide reach and social focus of the DAC model than they do the narrower and more technical framework of most other newer non-DAC donors.

Brazil’s ambitious reach may be less challenging to the DAC community than some other donors because Brazilian aid focuses on social programmes and agriculture instead of the typical heavy industry and resource extraction of non-DAC donors. See Figure 20.7 for a summary of the sectors that Brazil supports. As with the DAC donors, the largest category depicted is a

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Figure 20.7 Brazil’s aid flows by sector
Source: Tierney et al. 2011; data compiled from Aiddata.org
combination of a large number of sectors: social services, multisector, environment, communications, energy, water and sanitation, industry, mining and construction, trade and tourism, financial and business, and transportation. The largest unique categories in Brazil’s sectoral allocation profile are in many ways similar to the traditional DAC profile with health, agriculture, government and education comprising large shares (compare to Figure 20.4, left pane).

Brazilian aid comprises a somewhat unique model of South–South co-ordination in that it largely exports programmes and projects that have been successful within its own borders. Arguably, this may make Brazilian aid more effective than policies drawn up in Washington or London, as advisors on a project are often drawn from the very ministries that implemented similar policies in São Paulo or Rio de Janeiro (Glennie 2012). Still, this successful model accompanies Brazil’s efforts to build its economic and diplomatic power, especially in Africa, by creating inroads for Brazilian companies abroad. Further, some have criticized Brazil’s growing developmental and commercial ties to leaders with poor human rights records (Romero 2012). However, Brazil funds far fewer mining and industry projects than the other BRIC (Brazil, Russia, India and China) heavyweights, perhaps because it has no need to import oil—likely a major interest driving Indian and Chinese aid to build up energy industries in African recipient countries.

Despite some sectoral similarities, stark contrasts remain between Brazil’s young aid programme and more established donors’ systems. Without conditionality, Brazil’s aid may appear more attractive to recipients than DAC funding, but legal restrictions and understaffing create opportunities for fraud and corruption within its aid bureaucracy, especially given substantial recent funding increases (Smith 2011; Walz and Ramachandran 2010). Since Brazil remains a large recipient of aid, its presence in the global market for development may undermine traditional donor-recipient distinctions and the top-down approach to aid. On the other hand, Brazil’s aid programmes do not spark the scepticism and distrust with which the DAC community views Chinese or Venezuelan aid. Brazil has also been ‘much more cooperative’ in collaborating with other bilateral donors than India or China have been (Rowlands 2008).

India

India is beginning to have an impact in the development community despite remaining the world’s largest recipient of multilateral aid. The Indian Government began technical and economic co-operation projects in 1964, and its development assistance programme tripled between 2000 and 2010 (Mullen and Ganguly 2012). The Government announced the creation of an official development assistance agency only in 2011, planning to distribute US $11,000m. in the first seven years. It seems rather strange for a country as poor as India to send any money overseas; however, India’s aid programme fills several purposes. One is certainly to increase India’s presence on the global stage; another may be to counter China’s growing influence in other regions.

As depicted in Figure 20.8, a basket of small sectors combined comprises the largest share of flows (water and sanitation, health, communications, social services, education, humanitarian, and government and civil society). The energy, industry and transportation sectors are the largest unique sector-specific targets of Indian aid, likely designed to help to secure energy sources and provide necessary infrastructure for joint economic ventures. In this way, India appears to be following the past trajectory of the DAC members in placing strategic concerns above all else. Since India’s aid lacks conditionality like Brazil’s, it may also present an attractive alternative for recipient countries seeking to protect their policy independence, even if it deviates from generally acknowledged best practices for development (Mullen and Ganguly 2012).

With the Indian economy growing at a tremendous rate, India has found greater potential to reach other countries with development aid, thus making aid a more important diplomatic tool.
Along with India’s recent economic boom and diplomatic outreach has come more political leverage, and the state’s growing aid programme is also used to counter the influence of regional competitors such as China and Pakistan. Long-standing programmes to educate foreign civil servants in India have reaped dividends in diplomatic ties with neighbouring countries, and Indian firms gain an advantage in large infrastructure development projects that require 85% Indian contractor rates (Mullen and Ganguly 2012). Although almost 95% of Indian aid has gone to recipients in Asia and the Pacific, leaders recently pledged US $5,000m. in concessional loans to Africa, extending the country’s reach into regions previously dominated by Chinese aid.

**China**

Chinese aid has captured the attention and the scrutiny of the development community for a number of years now as the emerging heavyweight in global development assistance. But
Unfortunately almost no reliable data exist on Chinese foreign aid. Much of the financing flows that China provides to other countries likely do not meet the 25% grant element threshold to qualify as official development assistance (ODA) (OECD Development Co-operation Directorate 2012). Instead, growing Chinese demand for energy and foreign investment appear to have sustained a campaign to deepen economic and political ties with many countries, but especially with several resource-rich countries. Because China’s international co-operation mostly lies outside ODA, some suggest that DAC frameworks and institutions are unsuited to governing its approach to foreign aid (Bräutigam 2011).

China’s aid model differs more significantly from DAC practices than any other non-DAC donor’s, even earning it the characterization of ‘rogue aid’ from some worried observers (Naim 2007). Tight-lipped administrations have enveloped Chinese aid in a ‘shroud of secrecy’ until very recently, and the lack of available information has fuelled conjectures and assumptions of sinister motives behind China’s engagement with African nations. However, some of these concerns are unsubstantiated. For example, it does not appear that Chinese financing flows directly support investment bids or concessions for natural resource extraction (Bräutigam 2011).

Still, because of its emphasis on mutual benefit and lack of conditionality, the Chinese model of South–South co-operation may be less focused on sustainable development than it is on building economic and political ties that Beijing finds useful (Manning 2006; Naim 2007). China has never reported its aid flows or given project-level information, but the government did release its first White Paper on development assistance in early 2011. Although this may not signal a shift toward greater transparency in China’s aid, it may reflect a Chinese desire to inch closer to the international donor community on its own terms. China has begun to participate in the global development dialogue and, at the most recent high-level fora on aid effectiveness, its dissent from the DAC consensus proved influential enough to change the content of official agreements (Barder 2011).

Chinese aid is unique among non-DAC donors for its sheer size; the Congressional Research Service recently estimated Chinese aid as totalling almost US $2,000m. annually for the past few years (Lum et al. 2009, 3). Also, other newer donors tend to direct the majority of their aid toward neighbouring countries, but the larger ones still give to a variety of countries and reach most regions of the world, making China’s nearly exclusive focus on a few resource-rich African recipients highly unusual.

While data on Chinese aid flows have been difficult to obtain, we report some initial results based on recent data from a World Bank initiative using open source data. These figures should be considered with some caution, given that they are only based on a pilot of African recipients across a limited number of sectors. The Chinese financing flows to Africa are billed as ‘South–South cooperation’ but do not qualify as ODA. These data, however, were gleaned from a combination of reports verified by official sources (Foster, Butterfield, Chen, and Pushak 2009). China’s Information of the State Council issued the first White Paper on its aid in 2011, which could signify a move toward more transparency in its donor activities, but that is yet to be seen.

The results of using these data appear in Figure 20.9 and show that infrastructure projects, as well as oil and mineral exploration, dominate Chinese foreign aid. This orientation is likely geared to making joint ventures with Chinese corporations possible. While education, health and civil society projects comprise almost half of both DAC and non-DAC donors’ aid, no Chinese aid flows to these sectors. Although these data are only from a World Bank pilot effort, they offer some support to the suspicions of many that China is using development assistance to pursue and advance its geopolitical interests.
The Chinese aid model more closely resembles historical DAC aid than it does the current model. This difference is purposeful, as China seeks to expand its influence and secure resources by providing an alternative to the conditionality and donor-driven approach of the DAC. The Chinese aid model presents direct competition to the DAC with no conditionality, an emphasis on South–South co-operation and proactive engagement with dictators whom other donors have avoided (Rowlands 2008; Walz and Ramachandran 2010; Bräutigam 2009). This approach to aid has been highly controversial, but without more information it is impossible to assess the effectiveness of the Chinese aid model in improving welfare in its partner countries.

**Discussion**

Changes in the global aid dialogue reflect the DAC’s recognition that development co-operation involves a broader range of actors than ever before. DAC chair Richard Manning suggested in 2006 that:
Non-DAC donors and bilateral aid

[the DAC] should welcome, not discourage, a greater role by donors outside DAC. It is entirely logical that we move from a world dominated by North–South flows of aid to a much more multi-polar approach where the web of co-operation links countries of every sort. The DAC should not aspire to be a donors’ cartel. Greater choice for developing countries is in principle good.

\[2006, 382\]

The 2011 Busan High Level Forum on Aid Effectiveness reflected this understanding. As non-DAC donors’ growing economic clout translated to spots at the discussion tables in high-level meetings, they were able significantly to influence the resulting Partnership for Effective Development Co-operation, which was signed by a broad range of donors, developing countries, and non-governmental organizations (Barder 2011).

The Partnership reflects the delicate relationship between long-time donors and non-DAC donors, including newer non-DAC donors, Arab donors and the heavyweight BRICs. At China’s insistence, the agreement stipulated that ‘the principles, commitments, and actions agreed in the outcome document in Busan shall be the reference for South–South partners on a voluntary basis’ (Partnership, 1). This highlights the difficulties facing a more comprehensive global aid governance: in order to include more donors, agreements and partnerships lose some of their teeth. Because non-DAC donors such as China and the Arab donors place such high value on maintaining policy independence, agreements such as the Busan Partnership cannot articulate more than ‘shared principles, common goals and differential commitments’. As the Partnership jettisoned the DAC’s old unanimity requirement in favour of voluntary building blocks, it acknowledged the different ways in which development principles may be put into practice while attempting to reaffirm the end goal of sustainable development.

While greater inclusiveness could result in improved legitimacy through, for example, greater ability to co-ordinate, this conclusion depends critically on some assumptions. Most importantly, it assumes that the DAC model is somehow the right model and that, by including non-DAC donors in that model, sustainable development will be more likely. The competitive pressures that non-DAC donors introduce into the aid market have had such a significant impact because their rise has coincided with a growing recognition of the weakness in the DAC model. Although some claim that these donors support rogue states, free-ride on debt relief by reindebting poor countries and bypass standards for governance and the environment, the DAC is not without its own ‘flawed standards’, broken promises and unfulfilled goals (Woods 2008, 1220). The broadening landscape of bilateral aid can either help or harm the aid community as it faces a crisis of legitimacy. Certainly the variety of developing countries’ situations calls for a flexible and multi-faceted approach to aid, but, in order to produce effective development, sustainability and transparency must become the central criteria in global aid governance as a growing willingness to co-operate nominally translates to increased co-operation on the ground.

The wide range of allocation patterns among the four donors we considered highlights the variety that characterizes non-DAC aid. Still, each describes its aid model in terms of ‘mutual co-operation’ or ‘development partnerships’ based on the needs and capacities of recipient countries, offering in some sense at least a rhetorical alternative to the existing DAC standards for aid. It is important not to overstate the role of non-DAC donors: the information in Aid-Data all suggests that DAC donors dominate in the foreign aid arena. But non-DAC donors may be on the rise in ways that at least create alternatives to the standard DAC model. Our data most certainly underestimate the amount of non-DAC donor aid, but, even if corrected, the picture is not likely to look drastically different. Of course, this is an open empirical question to be resolved as reporting and tracking gets better and better.
Katherine Kitterman and Michael G. Findley

While smaller donors’ practices and sectoral allocation patterns are becoming more similar to the DAC’s, new heavyweights such as China and Venezuela appear to very consciously base their funding decisions on their own strategic priorities. Regardless of the motivations, growing non-DAC aid may be introducing competitive pressures into the market for development (Naim 2007; Woods 2008). This poses no inherent problem unless non-DAC aid undercuts sustainable development in recipient countries, but the concerns must have raised could be applicable to all donors (Kragelund 2008, Dreher et al. 2011). More experience with non-DAC aid and more research are needed to determine the impact of these aid sources on the ground. The landscape of foreign aid is most definitely shifting, but the changes may be much smaller and more varied than many expect. And it remains to be seen whether the non-DAC donor practices collectively amount to policies that are any worse than those that the DAC has produced.

Notes

1 Private donors such as the Gates Foundation are also key players on the international development scene, but unfortunately little data exist on private donors relative to public donors. More data is becoming available in recent years (see Büthe and Cheng, this volume; Büthe, Major and de Mello e Souza, 2012).

2 Note that Korea joined the DAC in 2010. Because we only examine aid to 2009, we leave its aid within the non-DAC figures.

3 The one exception is that 11% of Ukraine’s aid flows from 2005 to 2009 came from Poland.

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Private transnational governance of economic development

International development aid

Tim Büthe and Cindy Cheng

Introduction

This chapter examines the role of private actors in raising, allocating and implementing international development aid (understood as resources supposedly intended to lastingly improve the well-being of individuals and groups in another country). Private individuals and non-governmental organizations (NGOs) have long been important actors in the transnational governance of economic development through aid. Yet some private actors, such as foundations providing funds for development projects in other countries, have become much more prominent in international development during the last two decades while others, such as NGOs, have become far more numerous or have taken on new roles. Increasingly, an analysis of global economic governance through development aid without attention to these private players is not just incomplete but is likely to result in biased analyses and misguided policy advice.

Following the editors’ emphasis on ‘player shift’, we organize our discussion around a distinction between four different kinds of new actors (or actors who have taken on new roles): (1) transnational NGOs as a channel of delivery for public (governmental) development aid; (2) transnational aid NGOs as agenda-setters; (3) foundations and other private sources of development aid; (4) transnational aid NGOs as private providers of privately funded aid. For each of them, we discuss the sources of their power and influence and examine how ideas about development and aid have shaped the rise of these new players, identifying throughout promising and important areas for future research. In the final section, we consider peer-to-peer development aid and related innovative attempts to solve pervasive accountability problems in development aid.

New players in the global governance of economic development

Transnational aid NGOs as channels of delivery

The idea that governments of advanced industrialized countries should regularly spend a portion of their tax revenues to enable or accelerate economic development in other, poorer countries
is virtually entirely a product of the post-World War II period (Hough 1986; Millikan and Rostow 1957; Morgenthau 1962), though such development aid had precedents in ad hoc public foreign assistance. Regular private aid for poorer countries has a much longer tradition, as a number of short-term humanitarian initiatives for victims of natural disasters and interstate wars in the late 19th and early 20th centuries became permanent, transnational charitable organizations (NGOs). The Catholic transnational humanitarian aid organization, the Caritas Internationalis confederation, for instance, traces its roots to the first Caritas organizations in Germany (1895–97) and Switzerland (1901). Numerous war relief programmes set up by US organizations from the Rockefeller Foundation to religious communities and labour unions during World War I became permanent aid organizations thereafter (Bolling and Smith 1982, 10ff.). And the non-denominational, avowedly transnational Save the Children, founded in the UK in 1919, formally became the first multinational NGO in 1920 with the founding of a Save the Children organization in Sweden (Mulley 2009).

It was not until the 1960s, however, that some private transnational aid organizations began to focus primarily on long-term economic development, as they sought to shift their attention toward addressing the root causes rather than the symptoms of poverty and deprivation. This shift from short- to long-term objectives in the (still small number of) transnational humanitarian NGOs coincided with major increases in government ‘development aid’ programmes—first in the USA, followed soon by most other Organisation for Economic Co-operation and Development (OECD) countries. Yet, throughout the 1960s and into the 1970s, private transnational humanitarian and development organizations mostly kept their distance from their rich ‘home’ country governments, raising their funds from private sources and (largely) setting their own agenda for what was, even cumulatively, a small contribution relative to the rapidly growing government aid programmes (Bolling and Smith 1982, 19ff., 185ff.).

There were several reasons for NGOs to maintain genuine independence from governments. One important reason is that humanitarian and development needs often arise in the context of political conflicts in which governments are rarely seen as completely neutral. The International Committee of the Red Cross and many other NGOs have long maintained that such neutrality is an absolute requirement for access. At the same time, aid that improves the health or economic well-being of (parts of) the population in a sustained way may significantly redistribute power resources, which has prompted some NGOs, such as Médecins-Sans-Frontières (MSF), to explicitly abandon neutrality (in the case of MSF while maintaining strict independence from governments) (e.g. Barnett 2009). Even more importantly, many humanitarian NGOs have long viewed themselves as driven by personalistic compassion, altruism and other motivations that many see as incompatible with governmental bureaucratic administration. And, as Williams, and Kitterman and Findley (both this volume) show for both the traditional Northern donors that come together in the OECD Development Assistance Committee and the non-DAC donors, respectively, governments tend to use international humanitarian and development aid not just (or not even primarily) to foster economic development in the recipient countries, but as a multi-purpose instrument of ‘economic statecraft’ (Baldwin 1985), albeit with considerable variation over time and across countries (see also, especially, Bermeo 2010; Fleck and Kilby 2010; van der Veen 2011, 9ff.).

Even though most governments may not have prioritized the development objective of aid, this ostensibly primary goal provided a criterion against which the public expenditure could be scrutinized, which ultimately led to a much greater role for NGOs. To be sure, an economically inefficient but politically astute divergence between practice and rhetoric can sometimes be maintained for a long time (Weaver 2008). Yet, by the early 1970s, the ineffectiveness of ‘development’ aid was increasingly apparent, resulting in a legitimacy challenge to traditional
government-to-government aid. Critics initially raised questions about the technical expertise and administrative capacity of the developing countries’ governments, and later also charged that aid enabled and exacerbated corruption and waste in the governments of the aid-recipient countries (for such an aid-as-a-resource-curse argument, see Morrison 2009). NGOs, by contrast, were widely thought to be better equipped to reach the needy, have greater capacity for innovation, lower cost, greater speed and more flexibility in responding to emergencies, and lack the conflicts of interest that had often led government aid to be diverted to other uses. This led to a push for having NGOs build schools and hospitals, train teachers and nurses, teach more efficient agricultural methods and generally carry out many of the development projects for which previously funding would have been given to the government of the intended recipient country—consistent with the simultaneous neo-liberal turn in economic thought.

The result was a marked increased in the amount of development aid given by OECD governments to international NGOs and later also directly to local NGOs in developing countries, from a baseline of 0.2% in 1970 to an average of 17% by the late 1990s (Woods 2000, 9). Most of that increase, however, occurred in the 1990s, with substantial variation across countries. In the USA, the delivery of governmental bilateral development aid via non-governmental organizations and even for-profit private sector firms, permitted since the 1961 Foreign Assistance Act (Ahmed and Potter 2006, 116), became an official policy starting with the 1973 Congressional re-authorization of foreign aid, which called for increased implementation of bilateral aid via NGOs and private sector actors. After a slow start, the implementation of this policy accelerated under the Reagan Administration’s 1981 Private Enterprise Initiative (Congressional Research Service 1989; Ruttan 1996), which was continued and intensified during the Clinton Administration as part of its ‘reinventing government’ initiatives. Under Presidents Bush and even Obama, the enthusiasm for private delivery continued in the 2000s, though the substantial increase in US government aid in the aftermath of 11 September 2001 (9/11) actually initially led to a decline of the NGO share in the early 2000s.

As shown in Figure 21.1, which traces the share of bilateral governmental development assistance dispersed via NGOs from 2004 (the beginning of systematically comparable figures from the OECD CRS Aid Activities database) through 2011, the USA (thick line) today relies less on NGOs than several other OECD governments. Some, such as Sweden and the Netherlands, consistently commit a greater share of their bilateral aid to NGO aid delivery, albeit with much volatility in the Dutch case. At the same time, government foreign aid delivery via development aid NGOs remains close to zero in some European countries, such as France, and Asian countries, such as Japan and South Korea. Some attribute the difference to the stronger statist traditions or the relative weakness of economic neo-liberalism in Europe and Asia. However, practitioners such as Rifkind and Seka 2002) also have long noted a greater willingness of US NGOs to work with and for the US government, whereas many of the major European NGOs have restricted or refused government funds to maintain greater independence.

The ‘privatization’ of development aid delivery sketched above—as well as the ‘professionalization’ of humanitarian and development NGOs that it enabled and demanded—was generally enthusiastically received, not just by those predisposed toward trusting the private sector more than governments but also by a broad range of scholars and practitioners. Yet, this development also has prompted a slowly increasing number of criticisms (see Fowler and Biekart 1996 for an early overview). Some have argued that the stream of public resources to carry out projects largely designed and targeted by the funding agency bureaucratizes transnational development NGOs and undermines their ‘problem-solving’ orientation (Easterly 2006, 18). Others have warned that the availability of seemingly steady income in the form of government contracts initially leads to a proliferation of transnational development aid NGOs but then to a ‘scramble’
for those short-term resources, which distracts the NGOs from their development objectives to the point of undermining the supposed benefits—an unintended detrimental consequence of making development aid policies more market-like (Cooley and Ron 2002). Yet others have raised concerns about the proliferation of for-profit aid contractors, which ostensibly are more efficient than developing country governments, but are Western- or Northern-based, so that private aid delivery actually increases the extent to which ‘only a few cents of every dollar of aid ends up in the developing South’ (Berrios 2000, xiii). Strikingly, despite the many strong claims and increasing counter-claims, we lack unbiased, social-scientific comparative analyses of the relative efficiency or effectiveness of private versus public development aid delivery, except for Dietrich’s recent work showing that aid effectiveness differs by channel of delivery and that the relative effectiveness of NGO aid is conditional on the quality of public institutions in the recipient countries (Dietrich 2013).

**Transnational aid NGOs as agenda-setters**

Another major change is the rise in overt attempts to influence public policy or public opinion. Many humanitarian and development NGOs which used to eschew such advocacy, now explicitly include advocacy among their activities, and many new NGOs have been formed with a primary focus on advocacy. In contrast to NGO service provision on behalf of aid donor governments, this advocacy work of development NGOs has attracted increasingly systematic scrutiny (e.g. Prakash and Gugerty 2010), with some arguing that their most significant

![Figure 21.1 Share of bilateral governmental development assistance dispersed via NGOs](img)

Source: OECD CRS Aid Activities database
advocacy accomplishment has been to promote their own prominence within the development field (e.g. Chabbott 1999).

Such influence may be surprising because NGOs lack the tools of force and coercion, which states possess. They must instead use information, ideas and norms to persuade, socialize or pressure other players into taking their preferences into account (Risse et al. 1999). Yet, NGOs have been credited, for instance, with shifting the focus of the development paradigm from national economic growth towards individual welfare (Chabbott 1999). Chief tactics to exert such influence are largely those used by advocacy NGOs across various fields. These tactics include monitoring, public education, issue-framing, lobbying and participation in national and international policy conferences (Ahmed and Potter 2006; Albin 1999; Betsill and Corell 2007). In fact, Keck and Sikkink’s (1998) seminal typology of transnational advocacy tactics also applies to development NGO advocacy: (1) information politics: the timely leverage of information for greatest political impact; (2) symbolic politics: the use of symbols to boost issue awareness; (3) leverage politics: the use of material or moral leverage over more powerful institutions; and (4) accountability politics: the compulsion of powerful actors to adhere to policy and norms which they had previously agreed to.

Many of these strategies and tactics were, for instance, employed in the international advocacy campaign for education, launched in part as a corrective to the emphasis on the privatization of education, national testing and cost recovery in the 1980s. NGOs framed their symbolically powerful campaign as a campaign for ‘education for all’. Efforts to promote their position included information politics such as monitoring and publishing reports on donor and government performance in basic education. Yet, as Mundy and Murphy (2001) show in their analysis of the evolution of NGO advocacy between two major intergovernmental organization (IGO)-sponsored international education conferences in 1990 and 2000, unco-ordinated advocacy campaigns to hold governments accountable had little success at the 1990 conference. To improve their leverage, NGOs built stronger ties with each other and by the 2000 conference presented a coherent platform supported by 400 NGOs to lobby their case at the conference. Through these efforts they were able to push states to endorse ‘free’ as opposed to ‘affordable’ education, expand the definition of education to include early childhood education and adult literacy, and commit to annual review meetings.

While much of the literature depicts advocacy NGOs as powerful drivers of the development agenda, some researchers have emphasized that their dependence on donor funding severely constrains their ability to advocate autonomously (Cooley and Ron 2002; Edwards and Hulme 1996). In their study of the international education conferences, for instance, Mundy and Murphy (2001) show that demands that cut close to the interests of powerful donor states, such as specific resource commitments by rich countries, were sidestepped. In his case study of AIDS in Malawi, Morfit (2011) argues that donors’ overwhelming emphasis on AIDS has forced NGOs to take on AIDS in order to be both credible and financially viable as development institutions—to the detriment of other development issues: ‘What [the donors] would like you to do is go and sing and do a dance about HIV but linking HIV to things that matter is harder’ (Morfit 2011, 70). Research on advocacy organizations in Asia similarly finds that fads in donor funding make it difficult for NGOs to maintain both their credibility and their budget (Parks 2008). And since ‘much NGO advertising, media work and lobbying is driven by the need to gain a higher profile in the market-place in order to ensure a continued flow of resources from both the public and official donors’, NGOs may be advocating as much or more for themselves as for their causes (Edwards et al. 1999, 131).

If NGO funding needs seem to give ultimate agenda-setting power to donors, NGOs arguably retain much leverage thanks to their privileged access to information. At least in times of
crisis, NGOs are often the only sources of up-to-date information about conditions on the
ground. Even if they do not consciously take advantage of crises to influence the international 
agenda, how they frame and prioritize the intelligence they relay to governments is invariably 
coloured by their own norms and values, which affects subsequent government action (Stoddard 
2006). That said, humanitarian organizations might not be willing or able to share the 
information they have (Rieff 2002). Even Médecins-Sans-Frontières, prominently founded specifi-
cally to uphold the principle of ‘temoinage’, constantly wrestles with how to balance its desire 
to maintain access to the people whom it seeks to help with speaking out, which might cause it 
to lose such access (Bortolotti 2006; Wong 2012).

Determining whether or under which conditions transnational aid NGOs actually exert 
independent influence on the international development agenda is also complicated by the 
substantial heterogeneity of development issues, advocacy NGOs, and the governments targeted 
by those NGOs, as well as the lack of experience of NGOs with critical self-assessment (e.g. 
Bebbington and Thiele 1993; Fisher 1997; Nelson 2000). Factors that may determine NGO 
tactics, and whether a particular advocacy campaign is successful or not, include organizational 
structure (Cox 2011; Wong 2012), nationality (Stroup and Murdie 2012), issue attributes, actor 
attributes and network effects (Carpenter et al. 2011; Keck and Sikkink 1998; Lake and Wong 
2009; Nadelmann 1990). For example, Mundy and Murphy (2001) argue that the reason why 
prominent organizations not usually associated with education like Oxfam, CARE, World 
Vision and Save the Children launched education advocacy campaigns during the 1990s was 
because they perceived this issue to be relatively uncontroversial and programmable. However, 
at least for Oxfam, its affiliates’ limited expertise in education (an actor attribute) and few links 
to other education organizations (network effects) severely limited the success of their camp-
aign. None of this, however, amounts yet to a general theory of advocacy NGOs. Careful 
theoretical work that is clear and explicit about assumptions that render certain hypotheses context-
dependent, and empirical research strategies that minimize the number of simultaneously 
moving parts, will be crucial for pushing this literature forward.

Empirical work on these issues is further complicated by the increasing blurring of the lines 
between development and humanitarian NGOs (Barnett 2005), as well as between advocacy 
and service provision. And there are at least two reasons to think that their increasingly pro-
mminent, more overtly political role in policymaking is at least in part a function of their 
increasing importance as service providers. First, being government-funded service providers 
gives them incentives, resources and experience-based credibility to participate in debates over 
development aid and thus shape public policy in both donor and recipient countries directly. 
Second, their claim to relatively neutral expertise gives their pronouncements and actions 
legitimacy, which allow them to influence public policy indirectly by shaping the scope of 
politically palatable options available to states (Stroup and Murdie 2012, 426). Future research 
should therefore examine more systematically the short- and long-term interaction between 
service provision and advocacy of development aid NGOs.

Foundations and other private sources of funding

New private players have transformed the international aid and development landscape in the 
last 20 years by employing an unprecedented combination of financial resources, technology 
and social mobilization (Plewes 2008). Foundations, corporations and ordinary citizens have 
been most influential among these new philanthropic actors in development aid. The total (net) 
oficial bilateral development aid disbursed by OECD countries totalled around US $94,000m.
in 2011, of which about $77,000m. went to development projects. Meanwhile, private giving by philanthropic and religious organizations, corporations and individuals in 2010 totalled around $23,000m. (Adelman et al. 2012)—a very substantial amount, both in relative and absolute terms. Their substantial financial resources, as well as their often distinct understanding of how to achieve and implement development strategies have changed not only the way in which aid is dispersed but also how it is implemented.

**Philanthropic organizations (foundations)**

After World War II, the Rockefeller Foundation, Ford Foundation and Carnegie Corporation led the charge for sustained transnational private philanthropy (Bremner 1988). These foundations shifted the focus from redistribution to addressing social problems through ‘rational’ and ‘scientific’ study (Lagemann 1989; Parmar 2002; Hall 2006); some also saw themselves as an extension of US foreign policy (Spero 2010). To these ends, they financed research and research institutions, sponsored foreign students to study at elite US universities and nurtured intellectual and policy networks at home and abroad (Parmar 2002). They thus supplied the ideas and human capital for the increasing US engagement around the world (of the 191 university centres for foreign affairs research in 1967, for instance, 107 depended primarily on Ford Foundation funding (Berman 1980)) and influenced development discourse and practices in many countries around the globe. Their mix of paternalism and pragmatism shaped the implementation of the Green Revolution, education promotion in Africa and the development of vaccines, among other development agendas (Moran 2007).

While these older foundations continue to play an important role in international aid (Amove and Pimede 2007), new foundations launched by mega-philanthropists, such as Microsoft’s Bill Gates, eBay’s Jeff Skoll and Pierre and Pa Omidyar, and Google’s Sergey Brin and Larry Page, now eclipse them in terms of economic resources and, arguably, influence (Boulton and Lamont 2007). US private foundations’ grants for international development causes in 2010 totalled US $4,300m. (and had been as much as $6,300m. in 2008 before the financial crisis hit), of which 40% came from the Gates Foundation (Lawrence and Mukai 2012). In some issue areas, these resources also rival public funding. With almost all the Gates Foundation’s funds devoted to addressing global health problems, the $1,800m. that it spent on health issues in 2009 was just less than half of the $4,000m. dispersed by the World Health Organization, a UN IGO representing 194 countries.

The new foundations have not just vastly increased the non-governmental resources available for development projects, they also brought a new approach, ‘venture philanthropy’ (Brainard and LaFleur 2007), which seeks to apply the lessons that their founders learned in the business world to the realm of humanitarian and development assistance. Reflecting this approach, the Bill and Melinda Gates Foundation, for instance, states that its mandate is ‘to ensure that our investments achieve the highest possible impact, for the greatest number of people, over the longest period of time’ (Gates Foundation 2010, emphasis added). Thinking or at least talking about aid as investments has now spread even to traditional philanthropic organizations, such as the Rockefeller Foundation (Rodin and MacPherson 2012).

‘Venture philanthropy’ entails a problem-solving approach to development, in which specific issues are targeted, analysed and resolved. As a result, they also show a preference for vertically organized programmes, that is, programmes set up to tackle individual issues (Sridhar and Tamashiro 2010). The Gates Foundation, for example, provided the seed money to launch the Global Alliance for Vaccines and Immunization (GAVI), a public-private partnership that aims...
to increase immunization access in developing countries (Marten and Wiite 2008). In general, foundations have been targeting fewer issues and concentrating resources to achieve the greatest impact, mostly without a large administrative infrastructure (Benjamin and Quigley 2010).

Some herald the rise of ‘philanthrocapitalism’ as the beginning of a promising new era in international development. Bishop and Green (2009), for instance, argue that, because these high-profile philanthropists are unconstrained by elections, demands by shareholders for profits, or the need for external funding, they have leeway to implement long-term and creative solutions to address development problems. In 2010, for example, the Gates Foundation pledged US $10,000m. over the next decade to research new vaccines against diseases predominantly affecting people in poor, developing countries (Rooney 2010). By devoting such enormous resources to a single cause, the new philanthropists can put issues on the international agenda and even change the priorities of government aid programmes (Caines et al. 2004; Spero 2010).

Critics charge, however, that the new approach has yet to deliver real results (Edwards 2008) and question whether it ever will (Plewes 2008). One concern is that tackling problems in isolation (as early governmental development programmes had also done) disregards the fact that many problems in developing countries are interrelated, so that ‘solving’ one may exacerbate others. Tackling diseases on an individual basis, for instance, may have a large, measurable impact in the short run but is arguably undermining the establishment of broader horizontal health systems to treat all forms of ill health, which may be more important in the long run (Marten and Wiite 2008; Morfit 2011). The emphasis on maximizing measurable philanthropic returns on their investments has also led foundations to focus 45% of their resources to programmes in the relatively well-off emerging market economies and 20% on ‘global programmes’, leaving only 35% for programmes specifically geared toward the large number of least developed countries (Sulla 2006). Moreover, most of the funds earmarked for the poorest countries are channelled through NGOs and for-profit service providers in developed countries out of concerns over institutional and organizational quality in developing countries (Benjamin and Quigley 2010). This brings the new foundations into tensions with the core tenets of humanitarianism (Barnett 2011; Büthe et al. 2012). Another criticism is that, by approaching development as merely a technical problem, these foundations ignore structural and political impediments that ultimately lower the overall effectiveness of their efforts (Arnove and Pinede 2007). Edwards (2008) goes further, arguing that the presence of philanthrocapitalists in developing countries is harmful to democracy and civil society and that their very existence is indicative of unprecedented economic inequality. The net effect of the new ‘venture philanthropy’ thus is far from clear.

Future research should explore the activities of foundations other than Gates, which has disproportionately been the focus of recent research. This focus has good reasons—the US $10,000m. in spending on vaccines research pledged by Gates in 2010 exceeded the entire assets of the Ford Foundation, the second largest foundation in America. But many other foundations’ funding for international programmes has also greatly increased in recent years, both as a share of their overall expenditures and in absolute amounts—increasing almost 10-fold between 2001 and 2010 (Benjamin and Quigley 2010; Spero 2010).

Finally, research on the role of foundations in development has so far focused on US foundations, since they play a dominant role in this field. But non-US foundations have been growing in number and material importance in recent years. Variability in the definition of ‘foundations’ makes comparative analysis difficult, even across EU countries (Marten and Wiite 2008), and leads to estimates of non-US foundations’ financial contributions to international development that range from US $7,850m. (OECD 2012) to $16,900m. (Adelman et al. 2012).
Corporations

As in other areas of global economic governance, firms play an increasingly important role in development. To be sure, companies ranging from renowned multinational corporations to small, local proprietorships have a long history of giving to their communities. Most, however, have only in recent years begun to turn to development-related philanthropy, and systematic data are still scarce. A recent business survey reported a total of US $21,020m. in 2011 corporate philanthropic giving, with 14% of the total ($3,000m. for the sample of 214 multinational companies) supporting projects outside the country of the firm’s headquarters (CECP 2012). US companies have been estimated to have contributed a total of $7,600m. to humanitarian and development efforts in 2010 (Adelman et al. 2012). Corporate development philanthropy takes a variety of forms, from financial, managerial or direct material support of local projects, such as the construction of a school near the company’s places of business, to donations to a particular project at the national or international level, such as the establishment of a national park, or committing a share of profits to a broader development campaign.

A prominent example is the (PRODUCT) RED campaign, started in 2006 to raise awareness and resources for The Global Fund to fight AIDS, Tuberculosis and Malaria. Spearheaded by Bono, RED licenses its brand to different companies and products. In signing on to RED, companies including American Express, Apple and Gap agree to develop and advertise special, ‘RED’ product lines, then donate a percentage of profits from the sale of those products—on average 40%—to support the campaign (for details, see Brookings 2008; Ponte et al. 2008). Through 2012 the programme has raised about $100m. every three years for Global Fund-supported programmes in Ghana, Lesotho, Rwanda, South Africa, Swaziland and Zambia (RED 2012), whereas total private sector contributions to the Global Fund over the three years prior to the launch of RED had been $5m. (Dadush 2010, 1271).

Private sector companies have much to offer beyond their substantial financial resources (Carroll and Shabana 2010; Sabel et al. 2000). Firms that produce building materials, for instance, may efficiently combine in-kind donations of overstock with providing training for the best use of the materials. Managerial expertise and—arguably—a longer-term perspective than political leaders may make business leaders particularly well suited to tackling intransigent social problems. At the same time, transnational philanthropy to address humanitarian or development needs may yield substantial benefits for the firms. At the local level, engaging with—and benefitting—the community beyond paying wages and taxes can generate much valuable goodwill toward the company among local employees, political leaders, etc. At the transnational level and in a multinational firm’s home country, the company reaps the benefits of a reputation for corporate social responsibility (CSR).

Transnational corporate philanthropy might thus appear to be a ‘win-win’ situation for all but, like CSR, programmes generally, it has been the target of critiques from across the ideological spectrum. Critics on the right, following Milton Friedman’s arguments against any business activity that does not directly and demonstrably produce a profit for shareholders, worry about the inefficient use of resources and that corporate donations foster a ‘culture of dependency’. Critics on the left worry that companies, seeking to increase profits, will shift the development agenda toward short-term solutions of local problems close to their heart without much concern as to whether those solutions advance or are even compatible with larger development objectives at the regional or national level (Blowfield 2005; Frynas 2005; Jamali and Mirshak 2007). Some also worry that corporate CSR might distract from scrutiny of whether the company’s regular business operations are harmful to economic or human development and that all the talk of corporate philanthropy might encourage passing off self-serving
business activities as a contribution to development or the public interest. They point out, for instance, that companies participating in the Product (RED) campaign have spent far more on marketing their products with the new logo than they have generated in resources for development (Frazier 2007; Nixon 2008). Finally, development aid guided by a CSR logic holds little promise for the least developed countries, since Western multinationals continue to have only a minimal stake in those countries.

Such critiques even apply to in-kind donations, which some companies have made an integral part of their business model and public image. Toms, for instance, gives away a pair of shoes to someone in the developing world for every pair it sells. Donations of physical goods are associated with high storage and logistical costs, and the products that firms in advanced industrialized countries donate may be practically or culturally inappropriate for the recipient (Malkin 2007; Osman 2011). In-kind donations on a large scale also risk destroying local production and undermine the functioning of markets in developing countries (Anonymous 2009; Butler 2012). In-kind donations have also acquired a bad reputation because of numerous reports of expired medicines and food products, and discontinued or sub-standard manufactured goods, ‘donated’ by companies for a full-price tax write-off.

To assess arguments about the strengths and weaknesses of corporate philanthropy, including the severity of unanticipated but supposedly inherent detrimental consequences, we need systematic comparative analyses of a substantial number of cases. To date, we almost entirely lack such empirical analyses, particularly concerning the effectiveness of corporate philanthropy. As a valuable first cut, however, Metzger et al. (2010) compares the aid allocation of the Swiss multinational Nestlé with the allocation of Swiss ODA. Nestlé was chosen in part because it was identified by the International Chamber of Commerce as one of the corporations most actively engaged in international development (Kolk and Van Tulder 2006), supporting local community projects in 70 countries in 2007 at a funding level on a par with Swiss ODA. Metzger et al. found that Nestlé’s aid allocation has been less poverty-oriented than the Swiss government’s. And, while Nestlé favours democratic countries, it also favours more corrupt countries. Unsurprisingly, the authors also find a strong link between Nestlé’s distribution of foreign direct investment (FDI) and its corporate aid allocation. Generally, these findings agree with Porter and Kramer’s (2002) contention that corporate philanthropy is used primarily as a public relations tool.

Nestlé, of course, is but one company of many. Moreover, we lack good empirical data on the actual impact that corporate social responsibility has had on furthering development goals (Blowfield 2007), and the existing case study work lacks a systematic methodology, so that the most that can be concluded is that ‘CSR can work, for some people, in some places, on some issues, some of the time’ (Newell 2005, 556). That said, with 49% of young workers reporting that they are willing to take pay cuts to work for a business that practices CSR and consumers willing to pay a premium for products produced by socially responsible companies, it is clear that the impact of CSR on international development can potentially be great (Burson-Marsteller 2010).

**Transnational aid NGOs as truly private service-providers**

Discussions of the explosive growth in the number of ‘development’ NGOs and of the substantial increase in funds that governments now distribute via NGOs (and how the latter might explain the former) overlook another important change in recent years: the massive increase in the funds for service provision available to the larger, transnational NGOs from private sources. The annual budgets of some of the largest international humanitarian and development NGOs
have in recent years grown to the point where they exceed the entire foreign aid budgets of OECD countries as large as Italy.

Comprehensive estimates of the combined world-wide budget of international humanitarian and development NGOs are hard to come by, but the best estimate puts the total at $26,900m. for 2005 (Gatignon 2007), and a wealth of anecdotal evidence suggests further increases in recent years after stagnant funding immediately following the financial crisis. Maybe most importantly—and contrary to Wang’s claim that ‘there is no country where private giving is the dominant source of revenue for civil society organizations’ (2006, 3)—Gatignon estimates that more than 60% of the total combined budget of development INGOs (international NGOs) comes from private sources. It is thus increasingly private money that enables the delivery of services and investments in health, education, infrastructure, etc. in poor countries.

This growth in private aid is important for at least two reasons. First, it means that aid NGOs are not just competing with each other over the distribution of a fixed amount of public money, which has been a prominent concern in much of the literature (e.g. Bob 2010; Cooley and Ron 2002). Second, it may lead to an allocation of development aid that is more conducive to actually achieving positive development outcomes. A portion of aid NGOs’ private funds ultimately comes from foundations (some of which seek to support their home country government’s foreign policy) and from private sector firms (whose commercial interests might prompt them to defer to the preferences of their host country’s government). But many transnational development NGOs collect substantial and increasing sums through a large number of modest donations from private individuals. For those funds, the allocation decision is, at least in principle, made entirely by the NGOs themselves.

Why does it matter? Is NGO decision-making regarding the allocation of development aid distinctive? While there is a vast literature about the allocation of bilateral aid by governments and a substantial literature about the allocation of multilateral aid by international organizations, scholars have only very recently begun to address the issue of NGO aid allocation. Büthe et al., in a series of papers starting in 2005, were among the first to address this issue directly ((2005) 2012). Contrary to traditional statist approaches, which view NGOs’ actions as simply derivative of their home governments’ preferences, Büthe et al. argue that the density of discursive interaction among aid NGOs makes it very likely that they develop an identity with behavioural norms that are quite distinct from their home governments’. Specifically, the authors distinguish between the humanitarian discourse, which focuses on the moral imperative to relieve human suffering, with individual need but little else recognized as a legitimate criterion for prioritization, and a more consequentialist development discourse, which emphasizes sustainable, long-term effectiveness and efficiency. Both discourses are found among and within aid NGOs, though the humanitarian discourse has long been widely shared, whereas the development discourse has often been contested, because allocating aid where it holds the greatest promise of lasting change frequently means ignoring the plight of those who are worst off. Each discourse implies a distinctive pattern of aid allocation, which can be distinguished not just from government-driven allocation patterns but also from a series of other possible explanations for NGO aid allocation.

A key reason for the dearth of analyses of NGO aid allocation has been the lack of publicly accessible data, except where government co-financing leads to public reporting requirements (see below). To overcome this problem, Büthe et al. built an original dataset based on the detailed financial records of 40 of the major USA-based transnational humanitarian and development NGOs (identified through an expert survey) to analyse their allocation of strictly private aid across up to 116 of the 119 countries categorized by the World Bank as low or lower-middle income countries in 2001, including all the ‘least developed’ countries. They find no
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support for the common claim that aid NGOs systematically prioritize their organizational self-interest when they allocate private aid, nor for the hypothesis that NGOs’ private aid allocation is derivative of the US government’s allocation of development (or even military) aid. They also find only limited support for the hypothesis that aid effectiveness—emphasized by the contested development discourse—drives NGO aid allocation. By contrast, they find that objective measures of human need (gross domestic product (GDP) per capita, the Human Development Index (HDI), the Physical Quality of Life Index and the share of the population living below the poverty line) are strong predictors of private aid allocation by US NGOs, suggesting that the humanitarian discourse exerts strong influence.

However, as Stroup (2012) has shown, NGOs differ across countries; even national chapters of the same transnational NGO can differ substantially. Consistent with this argument, some recent research yields differing findings. The government of Sweden, for instance, co-finances many Swedish NGOs’ development projects. Analysing the resulting data (2002–06 averages), Dreher et al. (2007) find that the NGOs appear more guided by need considerations than the Swedish government aid agency when they decide which countries to enter, but NGOs are no better than the government when it comes to the distribution of aid among those countries. The government of the Netherlands, for instance, ‘co-finances’ Dutch development NGOs to the point where the state accounts for 85% of their budgets. This high level of resource dependence might explain why a longitudinal (GMM) analysis of the four largest Dutch development NGOs (Koch 2009) finds that their aid allocation from 1989 to 2005 closely tracks the allocation of bilateral public aid by the Dutch government, whereas objective need (measured by GDP per capita, life expectancy, or the Gini coefficient) does not appear to drive Dutch NGOs’ aid allocation to a statistically significant extent.

An analysis of Swiss aid data, which unlike the Dutch data allow differentiating between co-financed projects and projects self-financed by NGOs from private sources, comes to a more nuanced conclusion, based on tobit analyses of average aid allocation for 2001–05 across 126 developing countries. Nunnenkamp et al. (2009) find that objective need (per capita GDP, HDI, or the population living on less than US $2/day) is clearly a significant predictor of the allocation of purely private Swiss NGO aid, but not as clearly for government co-financed NGO aid. At the same time, somewhat puzzlingly, objective need is also a significant predictor for Swiss purely public bilateral aid, i.e. there is in the Swiss case little difference between strictly private and strictly public aid, which might be interpreted as an indication that Swiss NGOs follow the government’s lead when they decide where to allocate development aid. Such a conclusion is clearly rejected by Nancy and Yontcheva’s (2006) analysis of projects proposed by European NGOs and selected for co-financing by the EU Commission. Despite a dataset that only contains EU-selected projects (annual data from 1990 to 1999 across 78 recipient countries), public aid allocation is completely insignificant in both random effects and GMM estimations of NGO aid allocation. By contrast, the percentage of the population living below the poverty line (their—only—measure of objective need) is highly significant.

More research is needed not just on NGO resource allocation across countries but also within countries, as an allocation of aid to poor countries ‘does not necessarily imply that funds go to poor people’ (Kapur and Whittle 2010, 1153). In fact, until Brass’ recent study of NGOs in Kenya (2012), the conventional wisdom has largely been that they do not. Barr et al.’s (2005) study of 300 mostly domestic NGOs in Uganda in 2000/2001, which documents poor financial record-keeping and underdeveloped accountability mechanisms, has often been interpreted as showing that NGOs at the local level are not focused on the needs of the poor, even though the study does not in fact make this claim nor provide any direct evidence for it. More telling may be Fruttero and Gauri’s finding (2005, esp. 777ff) that community-level poverty,
landlessness, (il)literacy and level of consumption have no significant effect on the allocation of services by NGOs in Bangladesh, which tend to locate their projects close to major cities, though multicollinearity makes it very difficult to draw any firm conclusions from this study. Even a micro-level study of microfinance institutions in Bangladesh that praised them for focusing, within the more developed areas, on poorer villages and within those villages on the very poor, especially women, criticized these NGOs, however, for generally ‘not [having] assisted the ultra-poor’ (Zeller et al. 2001).

Brass’s study addresses the issue of NGO resource allocation within developing countries more directly than previous work. Her statistical analysis of 4,210 domestic and transnational NGOs across Kenya’s 72 administrative districts in 2006, complemented by field-work interviews, finds that health-related measures of need at the district level (access to health care, and HIV infection levels) are strong predictors of where NGOs decide to establish projects, though measures of other types of need (literacy and access to drinking water) are not significant. At the same time, she also finds that characteristics that are often seen as making a district more attractive for NGO staff (proximity to the capital Nairobi and density of paved roads or population density/urbanization) indeed lead to a higher concentration of NGO projects. But she cautions about adopting the standard ‘cynical explanation’ that the significance of these factors should be treated as indicative of NGOs’ ‘self-serving pursuit of convenience’. Instead, she notes ‘NGOs may strategically place their projects in areas where they can easily access a great number of disadvantaged people’ (Brass 2012, 394). In other words, given the large number of people in need in developing countries, NGOs may be seeking a way to bridge the pure humanitarian with the developmental objectives.

Last but not least, much more work is needed on the challenging issue of impact assessment. Here, it is noteworthy that several (of the few completed) studies find that transnational aid NGOs not only provide often highly effective short-term humanitarian relief but also have a significant positive impact on health, education and overall economic growth in the long-term. Zeller et al. (2001), for instance, find a substantively and statistically significant effect on both income and food/calorie consumption. Eversole’s study of NGO projects in several Latin American countries (2003) finds that they raise local communities out of poverty—at least relative to previously more privileged communities in the same country—by empowering them vis-à-vis traditional centres of political and economic power, Mohan (2002) cautions, however, based on a case study of Northern Ghana, that foreign NGO resources can also be (ab)used to create alternative patronage and power structures that are no more beneficial to the general population than the traditional ones. Interesting recent work on education interventions that had proven very effective at the local level in randomized control trials by NGOs suggests that scaling up the intervention to the national level works well when conducted by NGOs but not when undertaken by the government (Bold et al. 2013).

Conclusion: solving output legitimacy challenges through better co-ordination and accountability challenges through peer-to-peer aid and new technology?

The literature suggests that co-ordination problems are pervasive among the large number of often fiercely independent development NGOs, which might have only got worse with the entry of a plethora of new actors (see Brainard and Chollet 2008). Co-ordination is a well-known problem between different NGOs working on the same issue in the same country. In some cases, lack of co-ordination even affects the national chapters or sub-organizations of major transnational aid NGOs. For a long time, Save the Children, for instance, was (in)famous
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for the autonomy of its separate national chapters, which could have their UK and US chapters initiate separate and even competing/incompatible education projects in the same town in the same developing country. Such problems undermine the efficacy of aid and, with it, the output legitimacy of private governance of development. Some NGOs have begun to address the issue internally (Save the Children by requiring its national member organizations to co-ordinate their actions through its international headquarters; Stroup and Wong 2011), and for the broader range of new actors, some scholars and practitioners have begun to develop practical suggestions to improve co-ordination (e.g. Severino and Ray 2010). It is an issue of great practical importance in need of both sustained theoretical and empirical attention.

Finally, all variants of private aid examined above also face a dual accountability (and thus an input legitimacy) challenge. First, donors’ ability to hold service providers accountable is limited. The problem is particularly severe for individual donors who have traditionally contributed to development aid by making a donation to a development NGO. Each such body collects a large number of such individually small contributions, then allocates the funds to various development projects. The individual donor ordinarily has no involvement in, or influence over, those allocation decisions. Moreover, because the donors usually know little about the situation ex ante, and because donors often learn too little too late in order to assess whether the chosen projects are effective in advancing the development objectives and are carried out efficiently, those who undertake the ostensible development expenditures can (potentially) get away with corruption and extensive shirking vis-à-vis donors. Second—and at least as important, but traditionally even more ignored (see Ebrahim 2003)—the ostensible local beneficiaries have little opportunity to hold the service providers accountable, since they have no direct leverage over them and lack ways of communicating with the donors to exert indirect leverage.

Peer-to-Peer (P2P) aid seeks to overcome at least one and ideally both of the two accountability problems, using innovations in communication technology to allow individuals to influence international development practice and discourse at an unprecedented scale in what some call the ‘democratization’ of development aid. P2P development funding entails individuals providing loans or grants to other individuals (or small groups) through an organizational intermediary. The specifics of P2P programmes differ, but in general individual donors select projects to fund from a database of donees and their proposed projects. The potential donor thus gets to see relatively direct evidence of the (range of) local grass roots demands for the development project s/he might help fund. Some P2P-type programmes also let donors select a specific NGO or microfinance institution that serves as the local partner of the intermediary and in turn uses the funds to support numerous different projects in a given geographic or issue area. P2P donors then receive updates and reports on the status of their loan and/or the efficacy of their donation.

Among the best-known P2P intermediaries for loans in the microfinance tradition is Kiva, which has been credited with giving individual lender-donors a greater degree of autonomy and ownership over their contributions than ever before. These organizations have raised a substantial amount of (arguably often new) resources for development from individual donors. Since Kiva was founded in 2005, for example, over 826,000 small donors have used it to lend more than US $400m. in 67 developing countries (Kiva n.d.). Once borrowers pay back their loans and the associated interest, lenders can choose to withdraw their funds, donate their funds to Kiva (to cover operational costs) or loan their funds to another borrower, with 70% of lenders choosing the last option. Numerous other organizations have built on the Kiva model, such as MamaCash, a non-profit directed toward addressing women’s issues. A few, such as eBay’s Microplace, even allow donors to collect a modest interest rate (Katz 2007).

Among the best-known P2P intermediaries for grants in the tradition of charitable donations are GlobalGiving, GiveIndia and HelpArgentina. Like P2P lending sites, they allow donors to
choose projects that they want to support, but here the contributions are all donations. Since 2002, over 300,000 donors have given US$78m. to over 7,000 projects through GlobalGiving, while around $26m. and $5m. has been donated through GiveIndia and HelpArgentina, respectively (GlobalGiving n.d.; GiveIndia 2012; HelpArgentina n.d.). Though funds raised for P2P grants have been substantially less than for P2P loans, they have been steadily growing each year.

Just as important as giving donors greater control and choice at the outset are the feedback mechanisms built into this system to improve the efficacy and accountability of aid delivery. GlobalGiving goes as far as posting updates about the funded projects for both donors and donees to see, which allows donees to advocate according to their own needs, limits opportunities for misrepresentation and allows project organizations to build reputations for development implementation (Kapur and Whittle 2010). The best P2P intermediaries even find ways to get non-donee members of the local community to provide feedback, positive as well as negative. However, while community feedback may improve accountability, too much information may make the signal difficult to separate from the noise, and self-selection may cause problems when evaluating feedback reports.

Unfortunately, P2P aid as an empowering institution is not without critics and problems of its own. Kiva, for instance, encountered controversy in 2009 when a loanee revealed that individual donors do not actually fund the projects that they pick on the Kiva website, but that their money instead goes to the micro-lending institution with which Kiva partners to fund this and similar projects (Strom 2009). In response to the uproar, Kiva’s CEO Matt Flannery (2009) explained that, as Kiva grew in size, matching donors to their chosen donees became too challenging logistically (which they had been able to do in the past) as well as inefficient in terms of development impact. In fact, Kiva’s practices are hardly unusual. Most P2P loan intermediaries actually connect the donors to local microfinance institutions that are supposed to lend to borrowers with a project that is similar in profile to the one selected by the donor, rather than connect them to the selected individual(s)—though there are exceptions, such as GiveIndia (2011).

In terms of efficacy, research is scant. One scholarly study of Kiva finds that individuals appear to base their loan decisions on a rational set of criteria, indicating that the P2P approach is effective in distributing loans to the best possible candidates given the information at hand (Ly and Mason 2010). But such research does not address how effective the loans are in stimulating development, though the high repayment rate, 98.86% offers an indication that they are not inconsiderable. While the P2P model seems adept at empowering individuals and fomenting change on the grass roots level, the extent to which microloans can address systemic problems that may not be resolvable with any amount of capital, for example local corruption, is more dubious. Some see the success of social networking in mobilizing large numbers of people around social causes to address such larger issues. And indeed, following the 2010 earthquake in Haiti, for example, the American Red Cross collected almost US $4m. in two days through text message donations (Cashmore 2010). It is far from clear, however, whether such online networking—sometimes derided as arm-chair activism, slactivism or clictivism—actually advances the cause of development or might even deter would-be participants from engaging in more traditional forms of activism (Christensen 2011). Designing good research projects that address these questions in a compelling way will be challenging but also holds great promise.

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Notes

1 Bolling and Smith (1982, 2) identify an 1812 shipment of US flour and supplies to Venezuela as the first case of ad hoc public foreign aid, which might be considered development aid insofar as the supplies were intended to help Venezuelan earthquake victims to restore their livelihoods (see also Brown and Opie 1953; Curti and Barr 1954). There also is a long tradition of invoking economic development objectives on an ad hoc basis as a justification for colonialism and other ‘foreign adventures’—not just since the 18th century (Easterly 2006, 22–26) but going back at least to the time of ancient Greece and Rome. Many European countries’ modern foreign aid programmes started out on behalf of their (increasingly former) colonies (e.g., Morgan 1980; Sieberg 1985; Wilder 2005).

2 Dutch law requires that a certain percentage of all foreign aid be dispersed by co-financing NGO projects. That required percentage increased from 4% in the 1970s to 11% today (Koch 2009, 42).

3 Note also the important but greatly under-researched role of American academics and centres for development research at US universities, which render the set of actors even more diverse; see Kapur 2011.

4 The remainder was funnelled toward debt relief, strictly short-term humanitarian needs and administrative overhead. Statistics retrieved from the OECD website: www.oecd.org/development/aidstatistics/statisticsresourceflowstodevelopingcountries.htm (Tables 2 and 18).

5 A similar accountability problem arises in public aid, to which individuals contribute by paying their taxes to the national government.

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Part IV

Crisis and change in global economic governance today
The contradictions of post-crisis global economic governance

Daniel W. Drezner

We live in hard times. The 2007/08 financial crisis triggered the most severe global downturn since the Great Depression of the 1930s. During the first 10 months of the Great Recession, economic output, global trade and global equity values all plummeted lower than the first 10 months of the Great Depression (Eichengreen and O’Rourke 2010). The International Monetary Fund (2009) estimated that banks and other financial institutions lost more than US $4,000,000m. in the value of their holdings as a result of the crisis. Private sector analysts (Roxbrough et al. 2011) estimate that the global decline in asset values led to aggregate losses of $27,000,000m. in 2008. In an effort to spend their way out of the downturn, the USA, the European Union and Japan primed their fiscal pumps, saddling themselves with rapidly escalating debt-to-gross domestic product (GDP) ratios. The Pacific Rim economies suffered from drastic reductions in exports, the fuel for their growth engines. The least developed economies saw the immediate withdrawal of private capital flows and the tightening of trade credit. Based on similar downturns in the past, the hard times could last for the rest of this decade (Reinhart and Rogoff 2009; Reinhart and Reinhart 2010; Eichengreen 2011a).

These shocks to the system have put profound stress on global economic governance. As Moschella and Weaver observe in their introduction, the power, players and paradigms that comprise and influence international economic regimes remain maddeningly out of focus. Neither the power nor the pivotal players in global governance structures have been completely settled since the onset of the financial crisis. The paradigm that will animate these economic governance structures is also unclear. The world has clearly changed—but not necessarily in the ways that many international political economy (IPE) scholars would have predicted ex ante.

This chapter assesses the shifts in power, players and paradigms since 2008 in an effort to develop expectations for the future of global economic governance. Those expectations are decidedly mixed. Long-term shifts in the distribution of power and preferences have the potential to substantially decrease the likelihood of meaningful policy co-ordination at the global level. The number of actors possessing ‘deterrent power’ has increased, and the increase in uncertainty about power and preferences has made policy co-ordination unquestionably harder.

That said, there are two countertrends that suggest a more functional set of global economic governance structures for the medium term. First, contrary to expectations, the paradigm that animates the international economic order continues to be quite robust. At both the elite and mass levels, the demand for substantive alterations to the neo-classical economic paradigm has
been relatively muted. No set of grand ideas has supplanted the neo-liberal faith in economic openness and market liberalism. To use Kuhn’s (1962) meaning of paradigm, the post-2008 alterations to global governance have all been at the ‘normal science’ level of puzzle-solving. The changes implemented since the financial crisis represent—at best—minor tinkering to the governance of the global economic order. Second, the response to the 2008 financial crisis further reinforced the status quo set of policies. If historical institutionalism carries any weight at the global level, then the actions of both the great powers and global governance structures suggest that the core of the neo-liberal thinking that has often been associated with the Washington Consensus still has a surprising amount of life left in it.

This chapter is divided into five sections. The next section discusses the relationship between great powers and global economic governance and sketches the distribution of power in the post-2008 era. The third section discusses how this redistribution of power and the uncertainty surrounding the identification of key players will affect the effectiveness of global governance outcomes. The final section discusses the ideational and institutionalist countermovements that help explain the actual pattern of governance outputs since 2008, highlighting the challenges to efficiency and legitimacy as suggested in the Introduction to the Handbook. The final section concludes.

Great powers and global governance

The distribution of power plays a crucial role in determining the sustainability of global economic governance. Beginning with Charles Kindleberger (1971), international political economy scholars argued that a hegemonic power is necessary for any sustainable global economic order (Krasner 1976; Gilpin 1981; Lake 1993; Ikenberry 2000). A related wave of scholarship has pointed out the ways in which ‘supporter states’ were crucial to the preservation of global economic orders (Lake 1983; Stein 1984; Eichengreen 1989; Lazer 1999). Neo-liberal institutionalists (Axelrod and Keohane 1985; Snidal 1985) have countered that hegemony was not a necessary condition for co-operation in international economic affairs. International regimes, institutions or great power concerts could act as a substitute for hegemonic power—provided that supporter states were willing to buttress and adhere to the rules of the global financial order.

Nevertheless, even neo-liberals acknowledged that power was still the crucial criterion for membership in the ‘k-group’—the actors that must co-operate in order to articulate and enforce global economic governance. In terms of international relations theory, any actor that falls into the k-group of states that could provide the functional equivalence of hegemonic stability qualifies as a great power (Snidal 1985; Lake 1993). These are countries with the capability of forming a ‘hegemonic coalition’ that provides well-defined rules and authority relationships (Foot and Walter 2011). In a unipolar world, the k group is just one country; hegemony would be a special case in which governance outcomes mirror hegemonic preferences. In a bipolar world, k = 2; in a tripolar distribution of economic power, k = 3, and so forth.

The reputation and effectiveness of global economic governance is therefore a function of the existence of a great power concert (Drezner 2007). If a great power concert exists, then international governmental organizations (IGOs) are seen as critical actors in the co-ordination process. Whether through consensus or through great power coercion, the governance outcome will be viewed as effective, in that broad adherence to the codified rules should be observed. However, if no bargaining core among the k-group exists, then these same IGOs will experience intractable deadlocks, inconsistent articulations of policy and weak enforcement. While one rationale for global governance structures is their ability to increase the likelihood of
effective multilateral co-operation, these abilities are irrelevant if the distribution of interests is sufficiently diverse (Morrow 1994).

This raises awkward questions: Who are the players in the current k-group? What are their sources of power and the effect of their potential or actual exercise of power for the effectiveness and legitimacy of global economic governance? Prior to the 2008 economic crisis, it was straightforward to identify the great powers in the global political economy as the USA and the European Union (Drezner 2007). Even a cursory glance at world politics since the crisis suggests a redistribution of power, however. Indeed, the very definition of economic power is somewhat murky in the current global political economy. As the developed world’s relative power has waned, attention shifted to new emerging economies. The power of other actors, particularly China, has seemingly flourished at the same time that American power has seemed to wane. In 2010, China officially surpassed Japan as the world’s second largest economy and, according to at least one estimate, overtook the US economy in terms of purchasing power parity (Subramanian 2011). The International Monetary Fund projects China to overtake the US economy in terms of purchasing power parity by the year 2016. The US National Intelligence Council projects that, by 2025, China’s power will approximate that of the USA (NIC 2010). China has used its economic power to influence its near abroad, withholding rare earth exports to Japan after a Chinese fishing boat captain was seized in disputed territorial waters. It has also threatened the USA via its holdings of dollar-denominated debt to alter its economic policies (Drezner 2009).

In the absence of an undisputed hegemon, contemporary debates about economic power reveal the ways in which the concept remains a murky one in political science. Michael Barnett and Raymond Duvall (2005, 42) provide a useful and recent starting point, defining power as ‘the production, in and through social relations, of effects that shape the capacities of actors to determine their circumstances and fate’. This formulation rejects the notion that power is strictly a relational concept—i.e. what A can do to B—or that power can be measured strictly by material factors. Power can be a material force, but must also be considered as a resource that gains efficacy as it operates through the social world. Barnett and Duvall further parse out the various ways in which power works, identifying two key dimensions: the degree of relational specificity (direct or diffuse) through which power’s effects are produced, and the social medium through which power works (through the interactions of specific actors, or through the social relations of constitution). This approach has become the state of the art for international relations scholars.

In thinking about economic power, Barnett and Duvall’s discussion of relational specificity is useful. States are actors in the global economy but, as many of the contributors have observed, they far from the only actors. The global political economy comprises material and social structures that impose constraints on all actors in the system. Capital markets, global civil society and voting electorates all shape the ways in which states exercise power in the world (i.e. Clapp and Burnett; Porter and McKeen-Edwards; and Sell, all in this volume). The ability of states to affect and alter these structures in ways that advance their own interests is also a clear signal of power. Even if governments do not engage in direct influence attempts over other governments, the ability to manipulate global structures is in many ways even more significant. When the USA was able to propagate the ideas of the Washington Consensus immediately after the end of the Cold War, for example, it altered the contours of the global economy in ways that directly benefited the American system of capitalism (Williamson 1990; Yergin and Stanislaw 1997; Frieden 2006).

Another significant dimension of economic power depends on whether the actor in question is trying to preserve or change the status quo. Economic power affects statecraft through two
theoretical pathways: deterrence and compellence (Schelling 1960). In a deterrence scenario, countries use their economic resources to resist pressures from actors or market forces. In a compellence scenario, a powerful government threatens to use economic statecraft to extract concessions from other actors, or use market power to alter the rules of the global game. Deterring economic pressure by others is different than applying such pressure to others. As with military force, when dealing with economic statecraft, it is generally easier to defend than attack. Benjamin Cohen (2008) goes so far as to posit that the ability to deter is a necessary condition of the power to compel. Only after an actor has the ability to resist pressure from others will they contemplate whether they can be the actor to generate pressure. At a minimum, the ability to deter can give an actor ‘veto power’ in the global political economy (Tsebelis 2000). Countries possessing sufficient reservoirs of economic power should therefore have both greater autonomy of action and be better placed to apply pressure on other actors.

Combining these dimensions of economic power creates a 2 x 2 matrix that specifies different dimensions of economic power, as Table 22.1 demonstrates. Autonomous power consists of the ability of an actor to resist pressure from structural forces to alter its policies or policy priorities. Hegemonic power refers to the ability of an actor to rewrite or reshape the structures that govern the global political economy. Autarkic power represents a government’s ability to resist overt economic pressure from other actors to maintain its status quo policies. Finally, coercive power refers to the ability of a government to effectively use economic statecraft to alter the policies of other actors.

With these four categories clarified, it is possible to sketch how the past half-decade has altered the distribution of economic power. Of these quadrants, hegemonic power is clearly both the rarest and hardest to achieve. It requires an economy so large that it becomes a price-maker rather than a price-taker in global markets, and the ability to draft rules that are accepted even by recalcitrant participants in the global economy. Many commentators observed that, during the post-Cold War era, the USA possessed ample amounts of hegemonic power (Brooks and Wohlforth 2008; Mastanduno 2009). The financial crisis would seem to have defined the limits of American ability to dictate terms to capital markets, however. The year 2010 demonstrated these limitations quite clearly. Most of the other Group of Twenty Finance Ministers and Central Bank Governors (G-20) governments rejected the Obama Administration’s enthusiasm for continued fiscal stimulus, for example, choosing instead to advocate more in favour of austerity programmes in the developed world. Standard & Poor’s downgraded the US credit rating after the debt ceiling negotiations in the summer of 2011; Egan-Jones has downgraded US government debt on numerous occasions since 2008. The Federal Reserve’s second round of quantitative easing did not have the intended effect on either short-term interest rates or the exchange rate value of the dollar. As America’s debt-to-GDP ratio continues to climb, and as its relative market size declines, its hegemonic power will continue to decline. IMF staff economists (Ostry et al. 2010) endorsed capital controls as a policy option, going against US preferences on the issue (Gallagher in this volume). Looking at governance structures, the expansion of the Basle Committee on Banking Supervision and the Financial Stability Forum

### Table 22.1 A typology of economic power

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<th>Ability to deter</th>
<th>Autonomous power</th>
<th>Hegemonic power</th>
<th>Autarkic power</th>
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<td>Ability to compel</td>
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into forums that encompass all G-20 countries also shows the apparent dilution of US hegemonic power (Helleiner 2010; also Pagliari in this volume).

This observation comes with some important caveats, however. While US hegemonic power has declined, it has not declined by all that much. To date, the USA weathered the Great Recession better than other developed economies. US job creation and GDP growth have outpaced those of most of the other advanced industrialized economies. Despite the downgrades by some ratings agencies, and despite issuing a staggering amount of sovereign debt since the crisis started, US interest rates have remained at historic lows. The dollar is not going anywhere as the world’s reserve currency at any time in the near or medium future (Eichengreen 2011b). The USA has gone far further than other OECD economies in deleveraging its consumer and business sectors (Roxburgh et al. 2012). Furthermore, no other country has acquired hegemonic power at the expense of the USA. While China’s economy has increased in size and scale, it has not rewritten the rules of the game in any significant sector (see the next section).

China has demonstrated rising autonomous power—a trait it shares with other emerging markets. The financial crisis has rewarded countries with resilient economic profiles regardless of their devotion to free market orthodoxy. Indeed, as capital has sought out greater rates of return, the entire developing world has been able to dictate terms to markets in a way that would have been unthinkable a decade ago. After 2008 Brazil, South Korea, Taiwan, Thailand, Indonesia and Chile all imposed capital controls of one kind or another, undercutting developed country aims to keep capital markets unfettered (Eichengreen 2011c). Capital markets have refrained from punishing these countries because their growth opportunities are too large compared to the mature OECD economies. Spikes in commodity prices have also empowered commodity producers to ignore policy advice from the international financial institutions.

In contrast, the developed world—particularly the eurozone economies and Japan—have found themselves more constrained than ever before. The debt crises in the Southern Mediterranean economies and Ireland have forced dramatic changes in the continental version of the co-ordinated market economy. Almost every government in Europe shifted towards fiscal austerity as an economic policy, despite its unpopularity with the voting public. Similarly, Japan’s ability to continue running large fiscal deficits is under greater pressure as its debt-to-GDP ratio escalates and demographic vitality wanes. To date, the federal government in the USA has been able to resist pressure from ratings agencies and other governments to pursue austerity policies—although voters did impose some constraints via the 2010 elections. Still, the autonomous power of the USA appears to be largely unaffected.

Switching to autarkic power, all of the BRIC economies (Brazil, Russia, India and China) have undoubtedly increased their ability to resist economic pressure from other countries. Despite repeated entreaties by the USA, China neither accelerated its revaluation of the yuan nor took active steps to alter its export-oriented growth model. Beijing helped to scotch efforts in 2008 to finish the Doha Round of world trade talks, putting multilateral trade negotiations into a deep freeze (see Wilkinson in this issue). The other BRIC economies have also experienced increases in their autarkic power. India and Brazil were in the ‘green room’ during the Doha Round, effectively wielding veto power when necessary (Drezner 2006). All of the BRIC economies took steps to invoice trade in their national currencies rather than dollar (Eichengreen 2011b, 142–45). While these steps have been mostly symbolic, they demonstrate the ability of these countries to take such actions without repercussions in global markets.

At the same time, however, America’s autarkic power has also increased in recent years. China and other G-20 countries have used both diplomatic and economic pressure to force the USA into pursing more prudent fiscal and exchange rate policies, in order to keep the dollar relatively strong. US policy has remained unbowed in the face of this pressure (Drezner 2009).
Despite external pressure, the Federal Reserve continued to engage in quantitative easing, and the federal government extended its expansionary fiscal policy in late 2010 by extending the Bush-era tax cuts as well as the payroll tax cut.

This increase in autarkic power is not uniform. For example, Brazilian leaders had expressed profound unease with pressuring China on its foreign economic policies. Brazil’s foreign minister explicitly stated in 2010:

I believe that this idea of putting pressure on a country is not the right way for finding solutions. We have good co-ordination with China and we’ve been talking to them. We can’t forget that China is currently our main customer. 

(Beatie 2010)

The European Union’s ability to go it alone has also clearly eroded, as the country’s reliance on Russian energy and external financing has only increased over the past decade.

Finally, some surprises emerge in analysing shifts in coercive power. On the one hand, there is no question that China has increased its ability to coerce and induce other countries. China has used its capital surplus to influence small countries like Costa Rica on issues like recognition of Taiwan (Drezner 2010). Its foreign aid and foreign direct investment policies have secured significant reservoirs of goodwill in Africa and Central Asia (Woods 2008). Beijing’s unofficial embargo of rare earths also forced Japan to hand over a Chinese national after a clash over the disputed Senkaku islands. On the other hand, this increase has not been nearly as large as media reports suggest. China’s coercive power derives primarily from its growing consumer market, not from its control over raw materials or its control over currency reserves. Its attempts to use its foreign exchange reserves to coerce other great powers have been ineffectual (Drezner 2009). Its effort to force other countries not to attend the 2010 Nobel Peace Prize ceremony for Chinese dissident Liu Xiaobo, for example, had a minimal effect. Despite the long list of countries with strong economic ties with China, no democratic regime followed Beijing’s lead (Voeten 2010).

China’s coercive power has grown with its market size. Concomitantly, countries with sluggish or no growth have seen their market power eroded. Again, the principal victims are Japan and the European Union, as their growth has stagnated. US market power has been diluted somewhat, as its traditional allies in Latin America and elsewhere have found alternative export markets. Furthermore, capital has poured into the advanced developing economies since 2009, and long-term trends suggest that these private inflows will continue unabated (Roxburgh et al. 2011). These nations are subsequently less dependent on official creditors and great power patrons for key development needs. This erodes American economic leverage.

Table 22.2 sums up which countries are augmenting their economic power and which are finding their power eroding across all four categories. A few trends become clear from this analysis. First, China’s power has undoubtedly increased along most power dimensions. Second, the European Union and Japan have seen their power decline across a similar array of dimensions. The effects of the past decade on the USA has been more mixed, however. To be sure, American power has waned, but not in every category. The ability of the other BRIC economies to resist pressure from the developed world has unambiguously increased; their ability to compel, however, has not increased appreciably.

Stepping back, there has been a marked convergence in the ability to deter economic pressure—it has declined in many of the Group of Seven (G-7) economies and increased in most of the other G-20 members. US power has slightly declined and Chinese power has moderately increased. In essence, the increase in deterrent power has given more countries in the world a veto in co-ordinating policy in the global political economy.

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Global governance in a world of deterrent power and uncertain players: effectiveness challenges

The discussion in the previous section reveals that the k-group of great powers has expanded. Just how much it has expanded, however, remains uncertain. The uncertainty about which actors qualify for great power status is reflected in public opinion surveys, which show interesting cross-country discontinuities in the perception of power. This gap is revealed in the different national responses to the April 2010 Pew Global Attitudes survey, as seen in Figures 22.1 and 22.2. When asked to name ‘the world’s leading economic power’, a diverse array of

Table 22.2 Winners and losers in economic power

<table>
<thead>
<tr>
<th>Category</th>
<th>Winners</th>
<th>Losers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hegemonic power</td>
<td>No country</td>
<td>USA</td>
</tr>
<tr>
<td>Autonomous power</td>
<td>China, Russia,</td>
<td>European Union</td>
</tr>
<tr>
<td></td>
<td>Brazil, India</td>
<td>Japan</td>
</tr>
<tr>
<td>Autarkic power</td>
<td>China</td>
<td>Pacific Rim</td>
</tr>
<tr>
<td></td>
<td>USA</td>
<td>Latin America</td>
</tr>
<tr>
<td>Market power</td>
<td>China</td>
<td>European Union</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Japan, USA</td>
</tr>
</tbody>
</table>

Figure 22.1 Popular belief that the United States is ‘the world’s leading economic power’
developing countries—including two of the BRIC economies—had majorities of their populations name the USA. On the other hand, in the developed world, the results look dramatically different. The results show that in five of the original G-7 economies—including the USA, Japan and Germany—strong pluralities named China as the world’s leading economic power. In other words: the developing world still largely believes that the USA has retained its economic hegemony, while the developed world thinks that primacy has shifted to China. This dissonance has persisted in subsequent polling.

At a minimum, the post-crisis k-group of great powers includes the USA, the European Union and China. The previous section suggests that an erosion of American power has taken place—but the relative decline is not nearly as great as commonly perceived. The European Union’s decline has been more significant, but its market size and regulatory capacity still endow it with great power status when the union can act as a coherent whole (Bach and Newman 2007). The previous section also demonstrates the extent to which China has increased its power across all dimensions. It is now the second largest national economy in the world and possesses the world’s largest amount of foreign exchange reserves.

A case could be made that the k-group is even larger than the three governments mentioned in the previous paragraph. Other recent surveys of national capabilities have expanded the great power club even more (Gelb 2009). Possible candidates would include the other BRIC economies of Brazil, Russia and India, as well as other G-20 members such as Japan or South Korea. For issue areas in which the European Union is unable to maintain policy cohesion, the key members of that economic bloc—Germany, France, Great Britain and Spain—might merit inclusion.

Debating which country from this second list satisfies the necessary metrics for great economic power status would be counterproductive. Instead, the very uncertainty about which

![Figure 22.2: Popular belief that China is 'the world's leading economic power']
countries belong in this second tier is a factor that must be incorporated into any analysis about the future of global economic governance. There is no consensus within the USA, the European Union and China about the status of the second tier of countries. They could be viewed as great powers, supporters or spoilers vis-à-vis the global economic order. Indeed, there may not even be consensus within the candidate countries themselves—based on their post-2008 economic diplomacy, many of these countries seem to crave the prestige but not the obligations of great power status (Patrick 2010). Clearly, the k-group has expanded, but by how much is genuinely unclear.

A few implications jump out in looking at the new size and heterogeneity of the major powers. First, a lack of consensus about which countries really are in the k-group will allow misperceptions to fester. As Robert Gilpin (1981) has observed, the 'reputation for power' matters just as much as power itself. If enough actors believe that the distribution of power has shifted in a particular direction, then those perceptions can socially construct that reality for a limited period of time. If India is granted the perquisites of economic great power status, then it will also be expected to assume the responsibilities of that status. Collective perceptions can force countries to either shirk or take on ill-suited obligations—particularly if the perceptions deviate significantly from the material facts of life. These governments will also act opportunistically in this situation, claiming or denying great power status in accord with their economic incentives (Patrick 2010).

Second, the increase in the number of great powers automatically decreases the likelihood of effective governance outcomes. Most formal and game-theoretic models demonstrate that, as the number of relevant actors goes up, the transaction and bargaining costs of creating a concert necessarily increases (Axelrod and Keohane 1985; Koremenos et al. 2001; Drezner 2007). Introducing more actors into a small-n group also decreases the likelihood of a bargaining core existing among the participants. Even holding the distribution of preferences constant, the number of issue areas when governance outcomes will 'work' is automatically likely to fall.

Third, there are many reasons to expect a strong divergence of preferences for different actors with respect to the distribution of burden-sharing for public goods provision. The per caput incomes of the USA and Europe are far greater than those of China or the other BRIC economies. China will be reluctant to divert resources away from growth promotion to global public goods. Other developing countries will be even more reluctant—to the point where they are likely to deny their great power status. At the same time, the rising debt constraints of the advanced industrialized economies will make European and American governments far more reluctant to shoulder the burden of great power provision on their own. Even if there is an agreement on policies and public goods provision, there will still be distributional battles along the Pareto frontier (Krasner 1991).

Another implication from the previous section's power analysis is the reduction in the coercive power of the major economies in the post-crisis world. The ability of the great powers to apply coercive pressure on each other was always limited, but interdependence has further eroded the ability of the major economies to credibly threaten coercion in the first place (Drezner 1999). Even the ability of the major economies to coerce other countries has waned over time. Emerging markets have augmented their ability to resist economic pressure and widened their access to multiple markets, which has in turn reduced the overall efficacy of economic sanctions.

Tapping into the theme of effectiveness in this Handbook, this secular decline in coercive power decreases the likelihood of effective governance outcomes. The enforcement of governance processes relies upon a great power concert cajoling and coercing recalcitrant countries into compliance (Drezner 2007). If that is no longer an option, the likelihood of sham or hypocritical governance outcomes increases. Even if a great power concert can impose effective...
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coevolution on most countries, the quality of governance outcomes changes. Bringing the remaining countries into compliance becomes much harder. More actors are able to execute free-rider policies. This in turn undermines the cohesion of any great power concert. Even successful governance becomes harder to achieve, less efficacious and more fragile.

There is an interaction effect between the increased heterogeneity of the k-group and decline in effectiveness of collective coercion that exacerbates the problem of supplying global economic governance. The demand for new or reformed global governance structures is at its greatest immediately after a global crisis. During those moments of constitutional creation, great powers relied on strategic supporters to accelerate the spread of rules and services from the core to the periphery. In the 19th century, the United Kingdom sponsored both the gold standard and the principle of free trade. Neither concept went global, however, until crucial supporter states such as France or Germany embraced these concepts (Stein 1984; Lazer 1999; Nye 2007). The collapse of the interwar trading system was due to the defection of supporter states into spoiler states (Lake 1983). As US relative power waned during the post-war Bretton Woods era, supporter states like Germany, Great Britain and Japan played crucial roles in buttressing and extending the system (Mastanduno 2009).

While the Great Recession has not significantly weakened the USA, it has had an enervating effect on the support provided by both European and Japanese allies. Even with the inclusion of China, there has been a decline in the k-group’s coercive and supply capabilities. As previously noted, the current tier of supporter states possesses far more heterogeneous policy preferences than in the past. This makes it harder for any initial burst of governance to diffuse across the system. The weakness of the current k-group and the more heterogeneous list of supporter states are, by themselves, serious constraints on global governance. In combination with an attempt to reform the current global economic order, they are even worse.

The combination of these trends does not bode well for global economic governance. In situations of contested rules, countries will either engage in forum-shopping or create new forums as a bargaining tactic. These tactics erode the causal pathways through which regimes ostensibly strengthen international co-operation. Institutional regime complexity weakens the power of pre-existing institutions as focal points, raises the costs and complexity of monitoring and compliance, and creates conflicting legal obligations at the global level (Drezner 2008).

The eroding ability of the G-20 to supply effective global governance since the financial crisis is consistent with these dynamics. Ostensibly, the member states designated the G-20 to be the premier forum for our international economic co-operation at the Pittsburgh summit in September 2009. Since the start of the Great Recession, G-20 communiqués have contained policy pledges bordering on the grandiose, addressing issues ranging from offshore tax havens to food security, to climate change, to macroeconomic imbalances.

In practice, the G-20 had an excellent 2008, a decent 2009 and a desultory few years since on macroeconomic policy co-ordination. During the peak moments of the crisis, the member states banded together to pursue policies designed to stave off a global economic collapse. At the Washington summit in the fall of 2008, the countries pledged to pursue all available courses of action in order to forestall a worse recession. Even countries reluctant to engage in Keynesian policies, such as Germany, eventually capitulated to pressure from other G-20 nations to engage in stimulus spending. In the end, Germany contributed the third largest fiscal expansion in 2009 (Prasad and Sorkin 2009).

By 2010, however, the consensus on global policy co-ordination had eroded considerably, largely because of concerns about who would bear the burdens of adjustment. Other G-20 countries pressured China to allow its currency to appreciate in an effort to reduce
macroeconomic imbalances. China has grudgingly revalued the renminbi and continued to accumulate significant current account surpluses. G-20 members also pressured the USA to devote more attention to its role as providing the world’s reserve currency. Despite these entreaties, in the fall the USA Federal Reserve announced a second round of US $600,000m. in quantitative easing (Eichengreen 2011c). The first round of quantitative easing caused anger in Beijing because of fears that such measures would lead to an erosion of its dollar-denominated holdings. The second round triggered a much larger outpouring of criticism from the developing world and European members of the G-20 (Giles, Beattie and Oliver 2010). Both sets of countries were wary of hot money inflows leaving the USA and causing their currencies to appreciate, worsening their trade balances. Despite these pressures, the USA has focused almost exclusively on domestic policy priorities. In an end-of-year editorial the Financial Times concluded that ‘all in all, 2010 was not a good year for the global governance industry’, singling out the G-20 in particular. Based solely on the big issues confronting the G-20, it would seem that the diffusion of power and the proliferation of players has paralyzed global economic governance.

Paradigms and path dependence in global economic governance: legitimacy challenges

A strictly materialist analysis of power and players after the 2008 financial crisis would lead to scepticism about the future of current global economic governance structures. Despite the diffusion of power and the increase in the number of salient players, however, there are still two causal mechanisms that can sustain the global economic order. The first is if all the relevant actors continue to embrace a common economic paradigm. The second is, in the presence of uncertainty, experts can carve out a path-dependent set of policies that get reinforced over time. Both causal mechanisms have been at play in the years since the 2008 financial crisis.

Many scholars have argued that a crisis will often discredit the hegemonic set of economic ideas—because they failed to prevent the crisis (Goldstein and Keohane 1993; Legro 2005; Blyth 2002). During the period of a search for new paradigms and ideas, actors will promulgate both ideas that define the key problems that triggered the crisis and solutions that spring from these new paradigms. If a political consensus builds around a new solution, then a paradigm shift does take place (Legro 2005). For example, as the Great Depression worsened, there was no expert consensus about the best way to resuscitate the economy. Prominent economists like John Maynard Keynes, who had been staunch advocates of free trade a decade earlier, reversed themselves as the depression worsened (Keynes 1936).

Following the 2008 financial crisis, there has been significant criticism of the ‘market fundamentalism’ that had dominated in policy-making and regulatory circles in the past two decades (Quiggin 2010; Roubini and Mihm 2010) and that has often been associated with the early version of the Washington Consensus (Williamson 1990). These criticisms have provided the foundations for the suggestion of a new paradigm for the governance of the global economy. At the same time, there was a great deal of hype about the possibility of a ‘Beijing Consensus’ (Ramo 2004; Jacques 2009; Halper 2010). The precise contents of this model are subject to debate, but key elements would seem to include state control of the economy’s commanding heights, segmented and state-controlled capital markets, resource nationalism, export promotion and the strategic use of technology transfer to spur innovation. Because of China’s high rate of economic growth, some scholars have highlighted China’s development model as a guide for other developing economies as well. Ferchen (2012, 1) notes ‘as the polar opposite of the Washington Consensus, the term expresses compactly the collapse of the
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Washington Consensus and the rising role of China in the world today. The Beijing Consensus’ implications for global economic governance could be significant: a greater emphasis on mercantilist trade, restrictions placed on cross-border capital transactions and less secure property rights.

In actuality, however, the Beijing Consensus is more myth than reality. It is telling that the term ‘Beijing Consensus’ was coined and embraced by Western pundits more than the Chinese themselves. As Kennedy (2010) and Naughton (2010) have observed, China has actually adhered to most of the major planks of the Washington Consensus. Chinese officials have been exceedingly reluctant to recommend their development model to other countries. Indeed, there is a striking lack of consensus within China about the relative merits of the Beijing Consensus (Roach 2009; Yang 2010; Yu 2010; Ferchen 2012); it is therefore not surprising that they have not proselytized it elsewhere.

At the level of global economic governance, China has taken a few steps to assert itself. It has requested and received larger quotas in the IMF and World Bank. Beijing applied the coup de grâce to the Doha Round in the summer of 2008. In 2009 the head of the People’s Bank of China suggested an end to the dollar’s status as the world’s reserve currency. Still, none of these moves involved a shift in the underlying paradigm that governs the global capitalist system. Most of China’s other demands have been to have a greater voice in existing global governance structures—not to revise their missions. Indeed, based on its behaviour since the start of the financial crisis, China has also not acted like a revisionist actor at the level of global economic governance. It has not advocated abandoning either the open trading system or the open investment regime. This is consistent with China’s greater willingness to comply with other global governance mechanisms over time (Foot and Walter 2011). At the level of paradigm, China’s behaviour has reinforced rather than subverted the existing set of hegemonic ideas.

Beyond China, at the mass level, faith in free markets and the open global economy has persisted despite the global economic crisis. A general assumption in public opinion research is that, during a downturn, demand for greater economic closure should spike, as individuals scapegoat foreigners for domestic woes. The global nature of the 2008 crisis, combined with anxiety about the shifting distribution of power, should have triggered a fall in support for an open global economy. The reverse is true, however. Pew’s Global Attitudes Project has surveyed a wide spectrum of countries since 2002, asking people about their opinions on both international trade and the free market more generally. The results show resilient support for expanding trade and business ties with other countries. Twenty-four countries were surveyed in both 2007 and in at least one year after 2008, including a majority of the G-20 economies. Overall, 18 of those 24 countries showed equal or greater support for trade in 2009 than two years earlier. By 2011, 20 of 24 countries showed greater or equal support for trade compared to 2007. Indeed, between 2007 and 2012, the unweighted average support for more trade in these countries increased from 78.5% to 83.6%. Support for free markets more generally has also held up over the past five years.

The other pathway though which the current system can persist is through unified expertise and institutional path dependence. Historical institutionalists have argued that the path dependence created by existing policy frameworks constrains and shapes the range of future policies. (Pierson 2004). At time t, a set of rules, R, is codified. These rules help to shape and reinforce the preferences of the salient actors. At time t + 1, the cost of switching away from R is somewhat higher. With each iteration, the reinforcement between actor preferences and the rules that bind them make it increasingly unlikely that R will be changed endogenously. If experts can function as a beacon in a world of uncertainty and control the setting of initial rules
in a crisis, they can foster consensus among the actors in the k-group. This is particularly true if these experts possess greater technical capacity than members of the k-group.

This appears to have been the case for some issue areas during the post-2008 years. On banking regulation, experts at the Bank for International Settlements were able to negotiate the Basel III banking accords despite fierce resistance from the private sector. On foreign direct investment, the International Monetary Fund was able to broker a code of conduct on sovereign wealth funds despite initial resistance from China and other capital surplus economies (Drezner 2010). Even the G-20 has proved more useful than the headlines would suggest. According to one metric, member compliance with G-20 commitments has steadily increased since 2009 (G20 Information Centre, 2011). It also proved useful in blunting protectionist pressures in both China and the USA. Stepping back, on multiple dimensions, global economic governance structures have worked to reinforce the open economic policies promoted in the Washington Consensus (Drezner 2012).

The legitimacy of global economic governance can have a path-dependent quality. If existing structures establish a reputation for reasonably effective governance, the gains from co-ordination increase while the costs decline (Willett 1999; Beeson and Bell 2009). Policymakers can use its institutional reputation to bypass domestic political roadblocks—just as the last generation of policymakers used the GATT/WTO (General Agreement on Tariffs and Trade/World Trade Organization) regime to reduce domestic audience costs. A constructivist take on the global political economy would therefore conclude on an optimistic note. Despite material shifts that complicate global economic governance, ideational and historical institutionalist mechanisms have reinforced pre-existing norms of economic openness.

Conclusion

The next decade will provide a very interesting proving ground for relative power of different causal mechanisms in the global political economy. On the one hand, shifts in the material distribution of power suggest that global economic governance will experience hard times. The deterrent power of a number of actors has increased—as have the number of players possessing a voice at key forums. This suggests that the effectiveness of global economic governance will deteriorate over time. On the other hand—and against expectations—the animating paradigm behind the post-Cold War global economic order has not been displaced. The persistence of the norms of economic openness and market liberalism suggests that, although distributional disputes will increase, disagreements about the social purpose of the global economic order will not. At the same time, the ability of global economic governance structures to function in the post-2008 years has cemented the power of experts predisposed to mild reform rather than radical revision of the global economic order. The future performance of these governance mechanisms will provide a very interesting window into the relative power of these causal logics. Yes, we live in hard times—but that also means, as IPE scholars, that we live in interesting times.

Note

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References


Contradictions post-crisis

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