

COLLECTIVE ACTION IN A FRAGMENTED WORLD

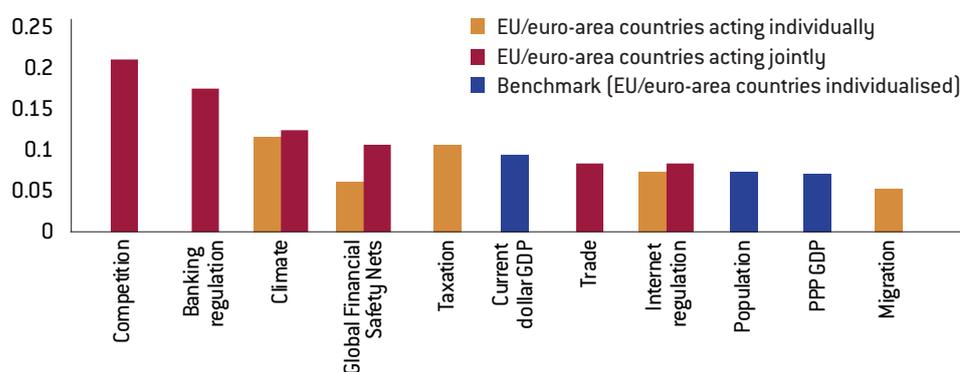
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INTERNATIONAL COLLECTIVE ACTION: CONCENTRATION INDICES IN SELECTED AREAS



Source: Bruegel. Note: the figure indicates in which areas of international cooperation collective action might be more effective, on the basis that collective action tends to be easier when significant players are only a few. The figure adapts the Herfindahl index of market concentration, which varies between zero (perfect atomisation) and one (complete concentration). The concentration scores are much higher for competition policy and banking regulation than for trade and internet regulation. The index is also influenced by whether EU countries act individually or jointly. See <https://bruegel.org/2019/08/how-long-is-the-head-table/>.

THE ISSUE

There is a greater need than ever for international collective action. From climate preservation to financial stability and internet security, heightened interdependence calls for common responses to global threats. Obstacles to global collective action are no less formidable. Beyond President Trump's stance and worldwide concerns over sovereignty, the China-US rivalry and the emergence of a multipolar world are impediments of a structural nature. The legal and institutional architecture of the rules-based global governance system looks increasingly incomplete and obsolete. A process of fragmentation has started to affect its core tenets. None of the main players is providing leadership. The US is increasingly questioning its post-war role; China is reluctant to invest in a system designed by others; Europe remains too weak and fragmented to offer sufficient leadership.

POLICY CHALLENGE

International collective action is in search of a new paradigm. It cannot rely anymore on global binding rules supported by universal institutions. New forms of cooperation have emerged in a number of fields. These are soft pledge-and-review mechanisms, cooperation between independent agencies, regional groupings, coalitions of the willing and open partnerships involving non-state participants and knowledge networks. To maximise the effectiveness of such arrangements, they should rely on a limited set of universal principles and be served by nimble and legitimate institutions. Existing international institutions should be regarded as globalisation's social capital. There are problems that will not be solved without having recourse to strong participation and enforcement mechanisms such as sanctions or pecuniary incentives. Europe should equip itself to be an effective player in this new global game. This calls for internal governance reforms.

1 STATE OF PLAY

There is a greater need for international collective action than ever before. The threats of catastrophic climate change and biodiversity collapse demonstrate the increased importance of global commons and the urgency of coordinating responses at global level. But the need for collective action also arises from risks to financial stability, threats to internet security, tax avoidance by multinational firms and mass migration, to name only some of the most prominent challenges.

The 1990s represented the high water mark of the collective action model characteristic of the post-second world war system. This system relied on universal, treaty-based institutions tasked with the organisation of international cooperation and the enforcement of legally binding rules in major fields of interdependence. At the time, the template became truly universal as membership of the Bretton Woods institutions was extended to Russia and the former Soviet bloc, while preparations were made for Chinese and Russian membership of the World Trade Organisation. However, efforts to replicate this template in fields such as investment, competition and climate action have been frustrated.

Once regarded as a milestone on the way to completing the institutional architecture of globalisation, the creation of the WTO did not achieve its aims. Since the mid-1990s, multilateral negotiations have stalled, trade governance has fragmented into a myriad of preferential agreements, and China's membership of the WTO has failed to trigger the convergence of its economic system (let alone its political system) with the Western model. The essential principles of the General Agreement on Tariffs and Trade (GATT) and the dispute settlement mechanism instituted with the creation of the WTO were nevertheless upheld, until the Trump administration's deliberate sabotage undermined the core tenets of the post-war order.

For the Bretton Woods institutions, the Asian crisis of the late 1990s was a turning point. Intrusive and economically misguided International Monetary Fund programmes were considered proof that these institutions were at the service of the Western powers. A decade later, the multilateral response to the euro crisis was regarded as further evidence of this built-in bias.

The global financial crisis did not result in a permanent upgrade to global governance. The response to the financial meltdown and the ensuing recession was swift and forceful, and the elevation of the G20 to leaders' level adjusted the political leadership body to the new reality of the global economy. But nevertheless changes to the rules and institutions of global governance fell short of the leaders' 2009 promise that "*a global crisis requires a global solution*"¹. Financial regulation was upgraded, but international macroeconomic coordination was short-lived and hopes that the crisis would provide an opportunity to reform the international monetary system were frustrated.

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

The governance of the internet epitomises the obsolescence of the post-war model. The emergence of the first truly global, borderless infrastructure has essentially been based on uncoordinated state and private initiatives based on broad principles and a series of information exchange protocols. Its governance

1. G20 London Summit - Leaders' Statement, 2 April 2009, available at https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf.

structures have remained weak and informal, and all attempts to give them a more formal structure have ended in deadlock. Since the start of the decade divergent preferences on privacy and the limits of free speech, and more fundamentally state control over national citizens, have given rise to a process of balkanisation. The unity of the internet is a thing of the past and the question now is what geometry will emerge from its fragmentation.

The historic core of the global regime – trade and finance arrangements – is undergoing a process of fragmentation. Global rules and institutions are still there, but their authority is fast diminishing. Existing multilateral arrangements lost muscle already in the 2000s and the early 2010s, and the process is accelerating. A new geography made up of partially overlapping blocs has started to emerge: trade rules are giving way to a new US-initiated bilateralism and the one success the WTO could claim, its conflict resolution system, is on its way to paralysis; development finance is undergoing a process of geographically-centred fragmentation, most notably as a consequence of the Chinese Belt and Road Initiative and its adverse consequences for multilateral debt relief procedures; in international finance, several layers of unilateral, bilateral and regional safety nets have piled up, not least because of the need to tackle the euro crisis, while the centrality of the IMF is being questioned; further disruption may well arise in the medium term with the emergence of a multi-currency monetary system.

2 GEOPOLITICAL OBSTACLES

The post-2016 political context certainly complicates global governance. International rules and institutions embody all that populist nationalists love to hate: a non-national definition of the common good, equality of nations, supranational bureaucracies, limits to discretionary power, rules-based decision-making and the influence of experts in policy design. More broadly,

concerns over national sovereignty are on the rise nearly everywhere.

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

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

Changes in the international stance of the US reveal America's deep and widely-shared doubts about the benefits of continued international leadership in the current context. In the post-war period up to the 2000s, the US mostly played by the international rules and furthermore acted as a guarantor and an insurer of the global system. This stance rested on the leverage that the system provided to the global hegemon, but also on the hypothesis that it was in its best interests to promote, uphold and guarantee a global rules-based regime. Yet the declining relative economic weight of the US is prompting a reassessment of the benefits that the 'indispensable nation' derives from trading-off exorbitant duties for an exorbitant privilege.

China's assertiveness questions the stability of the global system. Seen from Beijing, the rules-based system embodies the preferences and privileges of the incumbent powers. Whereas China values an open global

trading regime, it has no ownership of a system that was designed by Western powers and whose rules embody their preferences. The significance of the Belt and Road Initiative for global governance remains unclear, but it might be sowing the seeds of a different kind of system of international economic relations.

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

Europe remains the staunchest advocate of the multilateral system but it lacks strength and coherence.

As a rules-based construct, the European Union feels at home in a rules-based system and regards itself as a laboratory of global governance. But it is not ready to stand in for the US as an anchor of the system and its hesitant response to the euro crisis contributed to its weakening.

3 ECONOMIC CHALLENGES

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

The heterogeneity of preferences is an obstacle to collective action. As participants in global interaction have become economically, systemically and culturally more diverse, it has become harder to agree on rules and governance mechanisms. From the Bretton Woods conference in 1944 to Chinese accession to the WTO in 2001, the broadening of global governance proceeded by gradually co-opting new members into clubs whose basic rules had been written by their creators. The failure of the Doha round symbolically signalled that this process of homogenisation had come to an end. Developing countries, big and small, rightly claim that they cannot be simply asked to sign up to rules that were shaped by the preferences of advanced countries. But while they have often been effective veto players, their positive contributions have been rare. Notwithstanding the BRICS, developing and emerging countries lack unity and leadership.

The formal architecture of global economic and financial governance is increasingly at odds with the shape and intensity of interdependence.

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

The growing asymmetry of the global economic system weakens

multilateral rules and institutions.

Network-based interdependence in fields including finance, international currency, global value chains and data flows, confers exorbitant power and responsibility on whoever controls the nodes of the system. The assumption that all countries are equal has never matched reality. But interdependence once seemed to be an equalising force. This is less the case today than ten or twenty years ago.

Conflicting representations of the same reality are a serious obstacle to collective action. This is evidently the case for climate change denial, but also for less extreme forms of disagreement, as recently illustrated by European disputes over the solution to the euro crisis. Battles of ideas are often harder to win than disputes arising from divergent interests. This problem is bound to be significantly greater in a more diverse world. Investment in the building of common knowledge through the development of epistemic communities remains the most effective, though limited way to overcome such obstacles².

4 THE TOOLKIT FOR COLLECTIVE ACTION

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

Soft mechanisms that do not curtail national sovereignty can effectively tackle a whole category of collective-action problems. Solutions to such problems do not necessarily

require compulsion, hard international rules or delegation of decision-making powers to international organisations. The prisoners' dilemma model is less universally applicable than often believed and many obstacles to coordination can be tackled by ensuring transparency, creating trust and monitoring actual behaviour. In banking regulation, for example, significant results have been achieved through the negotiation of non-mandatory global standards and the thorough monitoring of their implementation. Such examples should of course not be overinterpreted: not all problems can be tackled by soft mechanisms. And the price to pay for the involvement of private players is often that they gain influence over the policy process. But for a whole range of problems, information exchange, indicative standards or pledge-and-review mechanisms can deliver results – on the condition that national behaviour is monitored effectively and transparently.

Cooperation between independent national agencies endowed with similar mandates can also achieve significant results. Historically, central banks have provided a template for international collective action by being able to cooperate effectively on the basis of domestically-oriented monetary policy mandates. The same applies to sectoral regulatory policies. The record of such cooperation is uneven: it has often been disappointing in the field of financial oversight, but significant results have been achieved in the competition policy field, where national authorities exercise extraterritorial powers in a cooperative manner. Independent regulators generally work on the basis of common knowledge and common beliefs, which provide a platform for coordinated action. They cannot by themselves internalise externalities, but they can and do prevent disputes, share information and organise coordination.

'Clubs' or groupings of countries can effectively address hard collective-action problems, but they

2. Epistemic communities are networks of knowledge professionals (scientists and policy experts) whose consensus and/or framing of issues helps to shape public policies. The Intergovernmental Panel on Climate Change (IPCC) and the network of experts and institutions around it provides a well-known example of such communities. Another example is monetary experts linked to central banks.

involve the risk of fragmentation.

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

The adoption of a dynamic perspective can strengthen otherwise weak incentives for joint action. Some global problems bring about strong incentives to free-ride on common disciplines, either by failing to commit or by failing to implement. Common-pool problems are of this sort and addressing them requires stronger cooperation incentives than those provided by trust-building devices and the monitoring of delivery against existing commitments. But these obstacles can be reduced (though not eliminated) by involving private-sector players, which can buttress otherwise feeble cooperation agreements. For example, the Paris Agreement on containing climate change does not involve any compulsion and even lacks mechanisms to enforce compliance with the commitments made. It is therefore vulnerable to the free-rider curse. But together with regulatory initiatives in key markets, it has been effective enough for part of the manufacturing industries' research and development efforts to be redirected towards zero-emission technologies. Their incentive to act is based on the perceived cost of losing

out in international competition by failing to keep up with clean technology developments. The effectiveness of such a mechanism does not rest on universal participation but on the participation of a critical mass of committed states and on the expectation that access to their markets will depend on the adoption of clean technologies.

Political leadership plays a decisive role by setting priorities and overcoming the curse of unanimity. Whereas the G20 has not lived up to the hopes that it would give rise to a permanent economic coordination apparatus, it has been much more effective as an orchestrator and agenda-setter. It has occasionally been an arm-twister too. An important example is taxation: whereas agreement on eliminating bank secrecy proved impossible to reach within the Organisation for Economic Cooperation and Development, or within the EU, the combination of US unilateral action, G20 pressure and OECD expertise made it possible to overcome opposition. A similar game might have started in the field of corporate taxation.

5 THE POLICY AGENDA

Effective collective action for the twenty-first century should make careful use of the limited political capital available for multilateral endeavours. It can rely neither on an outdated and disputed global governance model nor on non-committal intentions and the involvement of a multitude of stakeholders. The range of solutions available without recourse to hard international law is however significant. What is needed is to make best use of necessarily limited legal, institutional and financial resources. Collective action can rest on a series of principles that command universal support, such as national treatment for trade or the no-beggar-thy-neighbour principle in international finance. Such principles should be buttressed by a set of nimble institutions able to provide support to international cooperation, and their implementation should be

based on precise matching procedures that assign adequate resources, institutions and mechanisms to clearly identified problems.

A way to control the risk of fragmentation involved in the reliance on clubs or groupings of countries would be to require them be rooted in common universal principles ('minilateralism'). This is actually the case with regional or sectoral trade agreements: they are subject to WTO scrutiny, must respect fundamental principles such as national treatment and unless they meet certain conditions, they should uphold the most-favoured nation principle. Compliance with such principles has ensured some coherence in the evolution of the international trading system. Similar issues arise in a series of fields, from investment to regulation to climate to financial safety nets.

Existing institutions – which can be regarded as globalisation's social capital – should be requested to serve collective action beyond the confines of their sectoral remits. Global institutions were once regarded as the masters of sectoral fiefdoms within the multilateral system. But nowadays the fiefdoms hardly cover globalisation's territory. With the principles, procedures and governance they are equipped with, institutions should rather be regarded as wells of social and informational capital that international collective action can draw from. The evolution of the Bank for International Settlements (from the collector of German war reparations to the architect of global banking regulation), the IMF (from the coordinator of a financially autarkic world to that of a financially integrated one), the World Bank (from an infrastructure bank for Europe to, among other things, the promoter girls' education in Africa) and especially the OECD (from the administrator of the European payments union to, among other things, the assessor of worldwide education systems) shows that institutions – some of them at least – can be nimble. A key priority

for international collective action is to make the most of this social capital. This implies tasking institutions with responsibilities for *ex-ante* assessment, *ex-post* monitoring, evaluation and support for negotiation in fields that extend beyond their usual remits.

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

The involvement of knowledge networks, civil society and subnational governments ('polylateralism') can add to the effectiveness of otherwise feeble mechanisms. Shared knowledge is essential to identify issues and overcome obstacles to cooperation arising from divergent representations of the same problem. This is why the creation of the Intergovernmental Panel on Climate Change was a major step towards a shared awareness of problems and solutions (and the

absence of a shared knowledge base is also a reason why international agreement is so difficult in the field of migration). In domains that speak to public opinion like the preservation of the environment, public health or the fight against tax evasion, pressure from below might also help counter the incentives to free-ride that governments are subject to, and could help overcome obstacles to collective action. But polyilateralism risks being too weak to overcome obstacles to collective action in critical fields such as climate change.

In the absence of compulsory universal agreements, some collective-action problems can only be tackled by having recourse to sanctions, pecuniary levies and international transfers. Whereas it is wrong to assume that all international collective-action problems can be represented by a prisoners' dilemma game, it is equally incorrect to assume that all can be solved without mechanisms that contain free-riding. Without universally enforceable rules, such mechanisms can be provided by strict rules agreed to by countries entering into a club arrangement. This is most evident in the climate field: should a group of countries decide to implement significant carbon taxes while their trade partners abstain from introducing them, a border tax would serve both as a way to limit the risks of endogenous breakdown of the climate coalition, and as a way to ensure its members do not lose out in international trade. The critical question in the years to come will be whether the US joins the climate club (in which case it will most certainly introduce border taxes) or whether the EU and other climate-conscious players introduce border taxes in an effort to discipline the US and other free-riders.

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

Europe should equip itself to be an effective player in this new game. It cannot rely anymore on a global regime and on the US willingness to uphold it. External influence and leadership are European public goods that should be given priority and be buttressed by adequate internal governance.



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