Introduction

Walter Mattli and Ngaire Woods

Just as our project on the Politics of Global Regulation was nearing its conclusion, a global financial crisis erupted. It began with the rapid increase of defaults in subprime mortgages in the United States and a few other countries and quickly spread across highly intertwined financial markets, affecting millions of people. What went wrong? Who is to blame?

Broadly speaking, two related factors explain the latest global financial fiasco: inadequate regulation that generated a mismatch between private reward and public risk; and failure of regulators to comply with their supervisory duties.

Global banking regulation has been inadequate. Banks have long lobbied against more robust regulation, and they have been successful. The existing rules—the Basel II capital adequacy framework—allow large banks to use their own models for risk assessment in determining the minimum amount of regulatory capital to buffer against unexpected losses. The result has been rules that create a perverse incentive to underestimate credit risk; banks were tempted to be overoptimistic about their risk exposure in order to minimize required regulatory capital and maximize return on equity.

Regulatory oversight has also been inadequate. Regulators have taken a highly relaxed attitude toward oversight. They bought into the banks' arguments that complex derivative instruments improve risk management and distribution as well as enhance market efficiency and resilience. They outsourced critical regulatory functions to private-sector credit rating agencies. However, whereas in the past, rating agencies sold their assessments of financial instruments to investors, they now were being paid handsomely by the very banks whose securitized products they were rating, posing a serious conflict of interest.

The fallout of the financial crisis is staggering and still unfolding. While governments pour public money into shoring up the banking system, they and their regulators—under tremendous public pressure—are also compiling long lists of measures they pledge to implement to fix the global financial regulatory system. These measures include constraints on complex securitized financing through the adoption of global standards for valuation and disclosure, deeper capital cushions and enhanced supervision of investment banks and other nonbanking institutions, changes in the operation of rating agencies, and enhanced internationally coordinated scrutiny of global banks and brokerages.

Financial institutions are likely to fight tooth and nail against the adoption of most of these proposals. What then would it take to translate the aspiration for a more effective global regulatory regime into reality in finance and beyond? This is precisely the kind of question that this book seeks to address.

The first chapter sets out a framework for analyzing whether changes in global regulation are likely to occur and with what impact. Walter Mattli and Ngaire Woods contrast regulatory change that benefits narrow vested interests (as a result of "capture" by those whose actions the regulation is supposed to control) with regulatory change that achieves wider public purposes (common interest regulation). They then probe the conditions under which a global regulatory outcome is more likely to favor broad as opposed to narrow interests and vice versa. They highlight the institutional context within which regulation takes place. The more open, accessible, transparent, and accountable the process, the less prone it will be to capture. That said, while some rules are formulated in open and transparent negotiations, the implementation of the rules may subsequently be delegated to far less open, transparent, or accountable agencies, heightening the risks of capture.

Mattli and Woods argue that common interest regulation cannot be assured even in a formally open institutional context unless so-called demand-side conditions are satisfied. First is information. Without proper information on deficiencies and biases of the regulatory status quo, negatively affected constituencies will have no motivation to demand change. Disasters or demonstrations of failure can reveal to the public the negative externalities of no or poor regulation, triggering a demand for better regulation. But actual change will require at least two other conditions to be in place, one relating to (converging) interests of key actors and the other to ideas.

Change is a protracted battle pitting potential winners and losers and fought over multiple stages as the detail of regulation is negotiated, then implemented, monitored, and enforced. Change requires the sustained support of "entrepreneurs" offering technical expertise, financial resources, and an organizational platform if it is to succeed. Entrepreneurs know how to capitalize on a crisis or failure; they may be public officials, nongovernmental groups, or private-sector actors. The latter group has often been ignored. Yet private-sector actors may become powerful entrepreneurs for regulatory change if they are suffering from existing regulation either as corporate consumers of poorly regulated services or products; as newcomers to an industry whose regulation has been captured by established firms; as firms at risk from the negative publicity and fallout from an industry disaster; or from the fact that other firms with whom they must compete are not on a level playing field.

Entrepreneurs will be most successful in changing regulation where they can form a broad coalition against defenders of the regulatory status quo. To this end, a shared set of new ideas about how to regulate will often be crucial. When a disaster or failure triggers change, it also undermines the legitimacy of the ideas that supported the old order, opening up space for a battle over competing alternative ideas. Successful change is made more likely where new ideas provide a way to regulate that both offers a common ground to a coalition of entrepreneurs pressing for change and fits well with not-discredited existing institutions.

Chapter 2 develops the theoretical framework offered in the first chapter in three important ways. First, Kenneth Abbott and Duncan Snidal more systematically elaborate the five stages of the regulatory process: agenda-setting, negotiation, implementation, monitoring, and enforcement (ANIME). Their more detailed depiction of the regulatory process permits them to proceed to a second important contribution. They systematize the different competencies required for institutions effectively to discharge each of the five tasks. For example, whereas representativeness is vital at the negotiation stage, independence and operational capacity are more important for effective monitoring and enforcement. A third important way in which Abbott and Snidal take forward the analysis is through their exploration of a new emerging trend in transnational regulation which they describe as "regulatory standard-setting" (RSS). The process they describe involves combinations of firms, states, and nongovernmental organizations acting together as partners to promulgate norms or voluntary standards. They argue that these processes are emerging precisely because the different competencies of states, firms, and NGOs are required at each stage of the regulatory process. They draw their argument together in a "governance triangle" which depicts the variations across different RSS schemes that emerge as a result of different combinations of states, firms, and NGOs. Their interest in RSS stems from the observation that there is dramatically less regulatory control over transnational production than over domestic production, even as transnational production increases. One major issue they consider is whether RSS schemes, and the larger context in which they operate, can serve broad societal interests rather than being captured by particular interests. They find that states retain the authority to indirectly shape RSS processes involving firms and NGOs to ensure socially desirable outcomes. The likely effectiveness of such arrangements is probed further in chapter 5, which examines six cases of such new regulatory arrangements.

Chapter 3 presents the first of several case studies that illuminate the ways particular actors shape regulatory outcomes through their engagement at different stages of the regulatory process, their access to information, their capacity to lobby, their ideas for reform, and the institutional setting within which they participate. Eric Helleiner examines two international initiatives that have brought the restructuring of sovereign debts owed to private foreign creditors under new forms of regulation. Since 2003, almost all new international bond issues have come to include collective-action clauses, and an international code of conduct to govern sovereign bond restructuring episodes has been endorsed by the leading representatives of private creditors and public authorities in both emerging market and creditor countries. The process of regulatory change was initiated by the international financial crises of the mid- to late 1990s which demonstrated very publicly the costs associated with the old bailout model of handling sovereign debt crises. U.S. officials, key sovereign debtors, and lead private creditor groups then acted as "entrepreneurs" pressing the case for the new regulatory initiatives, particularly after the 2001 Argentine crisis demonstrated the costs of the absence of regulation in the post-bailout world. They succeeded in mobilizing a powerful pro-change coalition of private creditor interests, sovereign debtors, and financial officials in creditor states who were driven by a range of normative, distributional, and strategic motivations. The result was a regulatory standard-setting scheme akin to that described by Abbott and Snidal in chapter 2. At its core are voluntary principles agreed upon by a small group of partners from both the private and the public sectors. The theoretical framework of this book highlights that the likely weakness of the scheme lies in the limited and nontransparent procedures for implementation and enforcement which make it vulnerable to capture unless two sets of conditions emerge: first, that the procedures are opened up to public scrutiny; and second, that in the face of a crisis (such as that which began in 2007), a powerful and sustained demand for effective implementation and enforcement emerges, drawing together powerful actors, reinforced by a set of ideas that present an alternative to the previous regulation.

In chapter 4, Kathryn Sikkink analyzes the emergence of a new regulatory model in the treatment of human rights violations. In the period after the Second World War, the regulation of human rights was dominated by a state accountability model. In other words, states agreed on self-restraining rules among themselves through international treaties and the like. However, the enforcement of these rules was very weak. More recently, a new regulatory model of individual legal criminal accountability for human rights violations has emerged. Catalyzing the new, more effective regulation were the manifest failures of the old model such as in the Balkans and Rwanda. Human rights activists joined with like-minded states in pushing the new idea of individual criminal accountability, borrowed from the domestic criminal system. This change is too recent to measure its impact with any certainty, but the dramatic increase in human rights trials in the world and their geographical spread suggest that the individual criminal accountability model will not be easily reversed. The theoretical framework of the book highlights several conditions likely to affect this prognosis. First, as Sikkink points out, the new regulatory model has emerged in countries with a participatory and open institutional context. Second, the demand for human rights regulation has been pushed by a coalition of actors including some of those who supported the previous "impunity" model. However, the emergence of a new alternative set of ideas about restorative justice is now drawing some of those supporters away, creating a competing model of regulation which could harness key actors in the coalition that successfully promulgated the rise of individual criminal responsibility.

In chapter 6, Sam Barrows examines the dramatic changes that have taken place in global shipping regulation since the 1970s, including the passage of dozens of international conventions in shipping and the creation in many countries of effective monitoring and enforcement mechanisms. The catalyst for better regulation has been a series of maritime disasters that highlighted increasing risks as tankers become larger, faster, and more numerous. In 1967, the *Torrey Canyon* ran aground, causing the largest pollution incident ever recorded. Subsequent disasters, such as the sinking of the *Herald of Free Enterprise* and the grounding of the *Amoco Cadiz*, have spurred further refinements to regulation. In the wake of each disaster, a powerful pro-change coalition of public entrepreneurs, including influential environmental NGOs and well-resourced private-sector entrepreneurs (most notably insurance companies and classification societies), have pushed for better regulation. Even shipowners who benefited from little regulation reversed themselves when they realized that stringent new global standards and strict domestic-level enforcement in some regions would disadvantage them unless the standards became global (and therefore equally constrained all of their competition). That said, global regulatory effectiveness will depend upon "flag states" and "port states" enforcing the rules. The theoretical framework of the book highlights that this will depend upon both the institutional context in these countries and the sustained demand for regulatory change. As Barrows notes, in many developing countries, demand factors are weak as is the institutional context, limiting the likely effectiveness of global shipping regulation.

In chapter 5, David Vogel explores cases of the type of regulation conceptualized by Abbott and Snidal in chapter 2. In contrast to global shipping regulation, which is a state-centered system of rule-making, implementation, and enforcement, Vogel examines the emergence of "civil regulation" or transnational business governance associated with corporate social responsibility. He highlights that civil regulation has emerged because states have failed to regulate nationally or internationally issues of public concern such as labor and human rights, animal protection, or environmental standards. This failure has led policy entrepreneurs (NGOs often supported by some national governments and international organizations) to persuade firms to forge their own collectively self-restraining rules. The entrepreneurs have effectively challenged the idea behind previously existing regulatory arrangements; the idea that it is legitimate for corporations to be concerned purely with their private business has been replaced with the view that corporations have social responsibilities. This has created a highly visible and increasingly legitimate dimension of global economic governance, shifting the boundaries of what is considered "appropriate'" behavior for firms, NGOs, and states. That said, inadequate mechanisms of enforcement and accountability mean that the impact of civil regulation is both limited and uneven. Put in terms of the theoretical framework of the book, civil regulation lacks sufficient economic and political "demand" for more responsible global corporate conduct on the part of both firms and governments.

Shifting the focus from the demand side of global regulation to the institutional context within which regulatory processes take place, in chapter 7 Judith Goldstein and Richard Steinberg examine rule-making in international trade. Their study explores the shift away from rule-setting through a negotiated legislative process in the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO) associated with trade rounds. They argue that over the last fifteen years trade regulation has moved to a judicial process. The catalyst for this shift has been the failure of the trade talks and the new institutional context of the dispute settlement mechanism in the WTO. The failure of trade talks, including the current impasse in the Doha Round, has resulted from a regulatory system that permitted powerful protectionist interests to form in industrialized countries and into which developing nations, often speaking as a bloc, have exacerbated disjunctures in U.S. and European preferences on trade policy. The failure of the ministerial negotiating process has opened up space for public-sector entrepreneurs—the Appellate Body—to push for regulatory change. This shift is assisted by the fact that the same divisions that have undermined trade talks have made it increasingly difficult for the membership to provide a check on judicial lawmaking. Furthermore, the use of a robust dispute settlement mechanism has made public information about the costs of protectionism and has passed the burden of these costs on to exporters who may now face retaliatory actions in their main markets. The result pits the traditional coalition of national lawmakers and industries seeking protection against a new coalition of the Appellate Body judges, exporters, and other public and nongovernmental entrepreneurs who seek to use the more robust dispute settlement mechanism. Taken together, these developments suggest that we are entering a period of "judicial liberalization" at the WTO, led by the Appellate Body. This regulatory shift from the legislative to the judicial has increased the efficiency of the organization and enhanced open trade by freeing member states from capture by entrenched domestic interests. The argument underscores the influence of institutional context on global regulation, specifically by providing incentives and a forum within which reformers can demand more effective regulation.

In the final chapter of the book, Miles Kahler and David Lake reflect more broadly on the institutional context of global regulation, assessing the implications of emerging forms of global governance for the politics of global regulation. Existing economic models of international governance, they argue, would lead us to expect increasing supranationalism in global regulation as states pool decision-making powers and delegate implementation and enforcement. Yet this has not occurred in the past quarter-century. First, this is because two other modes of international governance exist: hierarchy, in which states transfer regulatory authority to dominant states for certain limited purposes, and networks, in which states, private actors, or both share regulatory authority through coordinated and repeated interaction. Hierarchies and networks serve as functional substitutes for supranational delegation to international institutions. This leads to a second reason why there is less supranationalism than predicted by economic models. The range of institutional contexts (supranationalism, hierarchy, and networks) creates a politics of its own. Actors will seek to influence which institutional form is chosen so as to advance their interests, which may be narrow, rent-seeking interests or broader, "public interest" rationales. The different institutional forms vary in their impact on distributional conflicts, the distribution of preferences, and the pattern of governance at the national level. Framed in this way, it becomes apparent that informal networks (or purely national governance) will be preferred by secure, concentrated interests who enjoy regulatory capture at the national level. Supranationalism does not appear to offer any inherent bias for or against regulatory capture relative to hierarchies or networks. Hierarchy will reflect politically powerful interests in the dominant state.

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