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*Leonid Grigoryev and Alexander Kurdin*

Mechanisms of global governance – economic analysis

Electronic Publications of Pan-European Institute 1/2014

# Mechanisms of global governance – economic analysis

*Leonid Grigoryev<sup>1</sup> and Alexander Kurdin<sup>2</sup>*

**1/2014**

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**Abstract**

The coordination of economic activity at the global level is carried out through different mechanisms, which regulate activities of companies, states, international organizations. Despite the diversity of entrenched mechanisms of governance in different areas, they can be classified on the basis of key characteristics, including distribution of property rights, mechanisms of transactions governance, mechanisms of expansion. This approach can contribute not only to classifying existing institutions but also to designing new ones. The modern aggravation of global problems may require rethinking mechanisms of global governance. The authors offer the universal framework for considering this problem and its possible solutions.

*Key words:* global governance, mechanisms of governance, global problems, global externalities.

*JEL:* F02, F50

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## 1 The need for global coordination

Due to the achieved level of international economic relations development it is arguable, that on the turn of the 21<sup>st</sup> century there exists a common system (though not a homogeneous one) of global economy. Every economic system implies the presence of mechanisms, coordinating its partakers' interaction. These mechanisms are determined by the respective sets of rules, which are formed either spontaneously or designed intentionally. We refer to them as "mechanisms of governance", though this might not be the most suitable term. To be more specific, it is not state regulation or purposeful management in question, but incorporation of all possible kinds of governance, including market, hierarchical and hybrid forms. Despite a certain consensus among economists regarding the typology and operating principles of the above rules, or governance, (we mean, specifically, their traditional division into hierarchical, market and hybrid/network governance types)<sup>3</sup>, there are some terminological discrepancies<sup>4</sup>.

A number of specific peculiarities of international interaction in the global system, such as the absence of supreme authority (accordingly, no guarantor of abidance by the rules and no norm-designing organization), state sovereignty and drastic dissimilarities in the institutional environment of different countries bring about the necessity to identify the modes of global economic relations governance as an independent subject for study. The existing system of global processes regulation is virtually based on a plethora of inhomogeneous (though classifiable) mechanisms, principles and coordination systems. In the 21<sup>st</sup> century the analysis of global governance problems, decision making processes dealing with the current issues of world economy and human development, is becoming more topical. In this article we review this complex topic in terms of the new institutional economic theory, which allows to make a step towards summarizing the multilevel phenomena of the present-day world.

Owing to their acuteness, a number of global problems are treated as a threat to sustainable human development. Before the second half of the 20<sup>th</sup> century global challenges, exclusive of those connected with collective security, had been ignored not only by individuals and corporations, but also by national governments. From the historical viewpoint security

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<sup>3</sup> A detailed study of these mechanisms was carried out in the framework of transaction cost economics (see, in particular: Williamson, 1996).

<sup>4</sup> Thus, to refer to alternative types of economic relations governance (hierarchy, market, hybrid/network) the following generalized terms are used: "forms of institutional agreements" (Shastitko, 2010), "coordination mechanisms" and "coordinating structures" (Auzan, 2011), "forms of transactions governance" (Kuzminov et al., 2006). Williamson uses the terms "governance structures" or "modes of governance" for the same purpose (Williamson, 2005).

problems were an obvious concern of governments, societies and elites, though their misinterpretation of the above problems was commonplace. Multiple regional unions emerged, partakers' conflicts of interests were settled on a compromise, decision-making and process-managing bodies were established. We believe that there is logic in the response of the world community to the emerging problems, though it cannot issue mandatory laws for over two hundred sovereign states and numberless international economic relations actors.

This article aims to systematize institutional solutions, setting the mechanisms of global governance, i.e., coordination for addressing global challenges. In other words, we attempt to draw up a "menu" of the respective institutional alternatives. The spheres, generating these challenges, – international finance and migration, global climate and trade – can be viewed not as "black boxes", sporadically generating institutional solutions, but as a set of subsystems (more specifically, partially independent systems of limited outreach), which inner regulating mechanisms are shaped subject to transaction characteristics in the given subsystem. At the same time it is not compulsory, that the optimal mechanism (or, at least, the most suitable of the available) be used in each of them at a given moment. Global economy subsystems are changing dynamically, which is paralleled by a simultaneous (though, not necessarily synchronous) evolution of regulation mechanisms. In the course of this process new institutions<sup>5</sup> are established both spontaneously and purposefully to either supplement or compete with the existing ones. In practice there may exist alternative mechanisms regulating similar international relations, as well as alternative institutions within the limits of identical mechanisms of governance. In terms of application it is essential that a better understanding of subsystems development logic in the future will allow to design regulation mechanisms suitable for various actors and the global community.

In this article we emphasize the important difference between the terms used for decision-making bodies and mechanisms on the one hand and their implementation management on the other hand. Speaking of "governance", particularly, of "global governance", the concept of the term needs to be specified. It involves an analysis of the problem, evaluation of its importance and acuteness, distribution of property rights. It also suggests identifying the order of making decisions about controlling actions, resource mobilization and the desired result of measures taken. Actual managerial actions and practical solutions of the emerging problems (achieving managerial results) do not belong here, they relate to the level of

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<sup>5</sup> Institutions are hereinafter used to denote the rules having an external enforcement mechanism.

executive managers. “Global governance” does not necessarily imply the presence of a direct “vertical” administrative action, (also see: Afontsev, 2002; Dynkin, 2011; Temnikov, 2004; Zuyev, 2011).

## **2 Theoretical and applied approaches to global regulation**

The development of economic globalization first lead to the gradual aggravation of a number of global problems, then – to the recognition of their existence and significance for the fortunes of the Globe and humanity followed by the awareness of the urgency of their consolidated solution, and eventually, the need for a solution to be found in a historically short term.

For almost half a century after the Second World War the evaluation of global challenges was invariably influenced by the division of the world into two economic systems, which implied different approaches to addressing the challenges of economic development and social organization. Alarms sounded by scholars and humanitarians were ignored from both sides. Moreover, the “cold war” worsened by the perspective of metamorphosing into a real war, was viewed as the topmost global threat. This global challenge was finally surmounted, though not without huge diplomatic, financial and engineering efforts. That period was characterized by large-scale excessive costs incurred by both parties, two “global governance” modes in partially isolated territories, conflicts in the Third World countries. Correspondingly, other world problems became collateral, little time was devoted to analyzing future perspectives and taking coordinated steps. Pugwash movement, the Club of Rome are some of the prominent examples of consolidated activities of the global civil society before 1990. However, their effectiveness was limited by the insufficient governmental efforts and public distrust towards their activities.

That period couldn't boast of significant achievements in addressing other global challenges, apart from the survival of the humanity under the conditions of bloc military confrontation. Nonetheless, the second half of the 20<sup>th</sup> century was marked by the formation of global infrastructure of international relations (though in its essence it is still more closely connected with international safety issues) – namely, the system of international agreements and organizations, partly coordinating resolution of aggravating and emerging problems.

The development of globalization necessitated a theoretical study of international relations issues. In its turn, this lead to the formation of a new field of science in the second half of the



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20<sup>th</sup> century – international political economy, embodying a number of theories (for a more detailed review see: Bratersky, 2012).

According to Chavagneux (Chavagneux, 2010), among the first ones was the *hegemonic stability theory*, originating from the work of Kindleberger (Kindleberger, 1973) and developing, in particular, in the works of Gilpin of 1980-s (Gilpin, Gilpin, 1987). In line with this theory, the stability of international rules is determined by the existence of a stronger state – their guarantor.

By 1980-1990-s new approaches were shaped, including the *theory of regimes* as institutional structures regulating certain spheres of global economy (Graz, 2010). Among the authors of this trend Krasner, Keohane, Nye (Krasner, 1983; Keohane, 1984; Keohane, Nye, 1987) need to be distinguished. Under this theory, no necessity of hegemon-state is assumed.

In his fundamental work “After Hegemony” Keohane distinguishes the “realistic” and the “institutional” approaches: the former is based on the perception of the world as the arena for the opposing states and links cooperation with the formation of alliances in the states’ struggle for influence. According to Keohane’s assessment, the realistic approach does not allow to explain the nascence in the 1980-s of multipartite mechanisms of international cooperation in trade, finance, environmental protection and other spheres. The institutional approach stresses the profits of international cooperation, shaping the demand for international institutions. Keohane deems the institutional approach to emphasize values and politicians’ competence (Keohane, 1984). It must be acknowledged, that these two approaches are supplemental rather than mutually exclusive concepts: the realistic approach is aimed at the supply of institutions, i.e. powers, able to generate rules, and, more importantly, guarantee their enforcement. The institutional approach (using Keohane’s terminology) is based on the demand for institutions.

As a political analyst Keohane in fact began to apply the new institutional economic theory to the analysis of international organization issues, asking the question: “How does contractual interaction between multiple parties have to organized to reduce transaction costs?” (Furubotn, Richter, 2005). This allows to connect his research to transaction cost economics, developed by Williamson (Williamson, 1979; 1991; 1996). In 1995 Keohane and Ostrom (who together with Williamson was awarded the Nobel prize in economy in 2009) published collected works “Local commons and global interdependence” (Keohane, Ostrom, 2005).

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The study draws a parallel between building mechanisms of common property management at the local level and international relations regulating mechanisms.

Alongside with the theory of regimes, developing primarily in the USA, in 1980 another theory of international regulation mechanisms arose in Great Britain– *the theory of structural power*, based on the decline of the state's influence accompanied by the growth of other actors' activities, and on the effacement of boundaries between national and international activities. This theory is believed to have been founded by S. Strange. The theory implies that actual authority in the global economy is determined by the actors' influence within the limits of four key structures: security, finance, information and knowledge, production (Strange, 1996). Since states, as a rule, are in a more advantageous position than non-governmental agents only in the security sphere, the theory of international political economy cannot be narrowed down to the interaction of states, while the organization of international relations is aligned with processes involving other kinds of actors. The reciprocal position of agents in these four structures, their interaction and the entrenching rules affect the situation in secondary structures, such as transport, energy or assistance to the developing countries.

Revisiting approaches to international economic relations regulation is associated with the changing role of the state both in domestic and in foreign affairs. We are referring to the denationalization tendency in a number of economic sectors. As a result of these transformations the concept of "governance" as a set of regulation mechanisms with no sizable involvement of the state gained popularity (Bevir, 2011). In this regard, the term "governance" is intentionally opposed to the term "government", impersonating interference by the state. This reading of "governance" should not be confused with the concept of "good governance", elaborated by a number of international financial institutions, especially, the World Bank: their interpretation "good governance" does not relate to the analysis of various mechanisms of regulation in a broad sense, but to ensuring transparency and absence of corruption in the existing mechanisms, primarily, within the frames of state bodies<sup>6</sup>.

In scrutinizing global economy, as it was mentioned above, the term "global governance" became widespread. According to the logic of opposition of the terms "government" and "governance", "global governance" is occasionally treated as a set of non-governmental

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<sup>6</sup> <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTGOVANTICORR/0,,menuPK:3036107~pagePK:149018~piPK:149093~theSitePK:3035864,00.html>.

mechanisms of global regulation, alternative to the hypothetical "global government" (Afontsev, 2002; 2010). Contrastingly, in some cases "global governance" is viewed as the activity of international (in the first place, intergovernmental) institutions, enabling states to coordinate interaction in certain spheres (see, e.g.: Strange, 1996).

We apply the broadest interpretation of the term "governance", which includes "all types of regulation", and reckon, following Bevir, that the outlined changes in the sphere of denationalization in 1980-1990-s can be referred to as "new governance" (Bever, 2011, P. 3-4).

In our interpretation the state and its instruments also belong to "governance". Correspondingly, the term "global governance" is used to denote a set of various mechanisms regulating the relations between economic agents at the global level, which is not equivalent to the global government, is not optimal from any fixed point of view, is also versatile and is an object of struggle for interests between major actors.

An important objective of modern studies in the sphere of global regulation is the formation of theoretical frames of analysis, allowing, on the one hand, to use a complex approach with regard to the heterogeneity of economic agents and the spheres of their interaction, which is incidental to the theories of structural authority and "global governance", and on the other hand, - to include in the analysis the attainments of theory of regimes, transaction cost economics, theory of property rights. Such attempts are known to political sciences (Rosenau, 2009).

In this respect we stress the necessity to distinguish the two problems: the rules of economic agents interaction as such (how their interaction is organized in the context of particular transactions) and the distribution of rights to set up rules (how and by whom, by the state or by private companies, the rules of these interactions are set). Confusion of the above issues leads to separate interaction mechanisms being linked to a particular type of economic agents. Thus, command, hierarchical relations are ascribed to the state, and market relations - to private companies. But that is not so: in the global arena states can enter into market relations, while companies can create large hierarchical or network structures, both internally and externally. In the view of the continuing debates about the "retreat" or the "return" of the state as a leading player both in national and international relations (Bell, Hindmoor, 2009), as well as about the appearance of various agents in the international arena, this distinction is essential.

### **3 Global problems and attempts at their resolution in the modern period**

With the end of confrontation between the capitalistic and socialist systems, it was widely believed, that the global community would focus its efforts on addressing common challenges. Nonetheless, it is a long way from conceptualizing the importance of global problems<sup>7</sup> to the willingness to take joint efforts for their resolution. Two decades after the fall of the socialist camp was not enough for that. Key issues, including the order of liability and costs distribution between governments, corporations and individuals, as well as the mechanism of regulating mutual relations within the limits of the "global agenda" remain unsettled in a number of spheres.

The rivalry of command and market regulation still exists, but now it lies not in the realm of ideology, but efficiency. For this reason, the global community is making effort to find a formula of economically justifiable mechanisms of allocating resources in addressing global problems, competing with national ones. To date there does not exist a generally acknowledged hierarchy (a set of priorities) of global problems. We can only sequentially show the structure of global governance applied to addressing international challenges, relying not on the chronology of their formulation (e.g. the 1971 report of the Club of Rome), but on how common and humanistic they are. In the first place, we emphasize the problem of global poverty, around which the UN Millennium Development Goals are centered, next - climate change prevention, affecting the entire humanity, though potentially, not to the same extent in the coming decades. Restrictions on the usage of non-renewable resources, preservation of biodiversity attract close attention of specialists and men of education, though are still not on the main agenda for elites, the middle class, and, consequently, politicians. We stress, that presently economic activities cannot be divided into internal ones (or "problem-free") and those having an adverse external impact. In the present day world economic activities, especially in large and developed economies are an integral process, in which it is often impossible to prevent international impacts of internal economic solutions.

Among the critical issues of the 21<sup>st</sup> century, specifically after the global crisis of 2008 -2009 (and during the current complicated recovery period), the problems, which have come to the

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<sup>7</sup> The generality of acknowledgement is understood as the predominance of a certain "mainstream" viewpoint in regard to their nature and character in the frames of the UN, relevant international organizations and leading countries (possibly, already at the legislative level). Needless to say, such approaches imply promoting a mass educated community of the world, scientists and politicians. However, acknowledging the existence and even acuteness of the problem is not necessarily extended to the accord about the instruments of its settlement, as well as costs and mechanisms, and, emphatically - the system of priorities and preparedness to incur adequate costs to the detriment of other objectives.

fore, are connected with maintaining sustainable growth and preventing new large-scale shocks. In fact, all countries are concerned by particular global problems in various combinations. The above mentioned problems include the stability of the global financial system and development financing; sustainability of raw materials markets; energy as a development factor, eradication of energy poverty, maintaining energy security; trade and investments regulation; supporting food and water balance in the world. Among the above-listed, the problems of climate and biodiversity preservation are gaining significance.

Every sphere ensuring utilization of resources and decision-making is specific. In particular, there are different independent or intertwined systems of international governance with a varying degree of control strictness. Presently, there are several types of governance aimed at resolving international problems.

*A. International regulation based on an organization with independent management*, who make prompt decisions in the sphere of distribution of resources (significant in their relation to the scale of the problems), and develop the international legal framework. Adoption of key rules, control and decision making are based on representation of the states (sometimes referred to as "great powers"). These organizations include the IMF, the World Bank and other international banks for development, the WTO.

*B. International regulation, based on an organization acting as an advisor and arbitrator* (suggests the presence of a judicial body or similar), which participates in the formation of international legal framework, but does not distribute significant resources single-handedly. This can be exemplified by the IEA in energy (though the use of petroleum stocks borders on immediate interference of type A), the ILO in the sphere of labor relations, the UNCTAD in international trade, Bank for International Settlements in Basel, international industry organizations, governing the activity of economic agents (ICAO in air transportation).

*C. International bi- or multilateral agreements*, binding on national governmental bodies or companies in the absence of a specialized guarantor-organization. This scheme is normally used for intergovernmental agreements in a number of spheres, as well as for international industry organizations, standardizing the activities of economic agents (ecology and biodiversity agreements, international industry standards).

*D. International framework agreements* (conventions, declarations), aimed at redistribution of resources for attaining a particular goal and implying voluntary observance on the part

national governmental or private agents in the absence of a specialized guarantor-organization. One of the examples is the UNFCCC.

*E. Non-governmental network organizations of the global civil society*, not having full voting status in the international arena, but taking active steps within the limits of their agenda. This, in its turn, impacts public opinion of different countries, as well as the activities of governmental and international bodies (WWF and other similar non-governmental organizations).

*F. Cartels, clubs, permanent or temporary country organizations, influencing the patterns of global economic activities* outside the said country or group of countries (regional free trade areas; BRICS; OPEC; countries; clubs of countries or organizations, imposing sanctions on separate countries or economic agents). A special case which we include in this mechanism are the decisions of separate countries or groups of countries (sometimes, the EU or even NATO), meant to become common rules for the agents in global markets. In their time, the USA passed the "Patriotic Act", which significantly affected the global financial sphere. Judgments of American courts often involve economic agents outside their jurisdiction. The USA, EU and clubs of countries resolve on economic sanctions to be imposed on these or that countries or companies for political reasons. Thus, separate countries and their clubs partially create precedents beyond common law or attempt to make up for the slow response of global coordination bodies.

*G. Self-sustaining activity of economic agents (companies) in conformity to national regulation (inside their country) in the absence of specialized international organizations and agreements.* This implies regulation in the frames of the national legislation, the practices of international business conduct and common principles of international interaction in this sphere - this is how international goods and services markets operate. Furthermore, state agencies can operate in global markets using similar principles, e.g. international loan markets.

The described types of regulation are partially overlapping. Thus, if a club secretariat is established, whose decisions are binding (at the level of executive authority) on state agencies of club members and/or which is entitled to dispose of certain resources of the country in its own discretion, then in such case mechanism F can be referred to mechanism A, applied at the regional, and not the global level. If the said secretariat does not have such freedom, but has a deciding vote or acts as an arbitrator, then mechanism F is equivalent to

mechanism B, but only inside the group of countries. In a number of cases mechanism E is similar to mechanism B, though not at the level of governments, but of non- governmental organizations or private companies. Contrastingly, mechanism G has to be divided into markets for private companies and markets for states or state companies.

The attempts of countries and their clubs to set rules for the "outer" world, which is implied by mechanism F, are triggered by the differences in political and economic interests of "great powers" as well as by the peculiarities of collective decision-making, e.g., the specific character of voting (the right of veto) in the UN Security Council. Moreover, such tendencies, affecting the mechanisms of global regulation, are observed not only in the sphere of international security. The potentially parallel elements of international regulation are now also created by the countries of BRICS, primarily, in the financial sphere, which is caused by the discontent with the nature of regulation in the IMF and Bretton Woods organizations in general (Grigoryev, Morozkina, 2013). In a sense, mechanisms E and F shape an experimental field, in which global regulation elements are fine-tuned (or, de facto, introduced) to further influence the nature of world economy and execution of mechanisms A, B and C. Obviously, an influx of innovations comes from market regulation (G).

The choice of a particular mechanism (system) of global regulation is historically preconditioned by the scale and nature of the problem (object), the scope of partakers, the amount of transaction costs in the absence of a uniform global institutional environment, the extent of problem conceptualization on the part of main actors and their willingness to cooperate (sound assessment of the potential losses in the absence of a compromise). In fact we are referring to a wide range of instruments intended to more or less efficiently bridge the gap (in terms of capacity) between the existing norms of regulation applied to a particular problem or uncontrollable sporadic developments, sometimes producing adverse effects.

#### **4 Global externalities**

In their essence, global problems are the problems of global externalities with regard to countries and economic agents. Global problems are not the aggregate of national problems. Every particular country may face its own problems, connected with climate, environment, finance and energy, which are settled at the national level. Global effects are produced by a clash of interests at the international scale, when the activities of economic agents in one country indirectly influence the interests of economic agents in other, even

remote regions. For a particular economy or region externalities are extraneous collateral effects originated by third countries, as well as the accumulated issues of global development which the object<sup>8</sup> is facing. Regulation of a certain sphere is carried out in conditions of the entrenched results of development, which often have already drawn externalities or can draw them in the future. In the recent decades the processes of globalization have not only generated externalities of new phenomena, including the beneficial ones (a revolution in information technologies, expansion of new technologies), but have also aggravated global effects, aligned with the properties of prior development periods (specifically, the industrial period).

Global problems emerge in various spheres: from energy resources markets to food markets. Both governments and companies, in exercising their sound policies, occasionally affect interests of foreign agents, which lead to the nascence of an externality. If the number of economic agents incurring costs reaches its threshold, there appears an urgent need for internalization of such an externality. The latter has several stages:

- identification of the effect, conceptualization of costs and losses (reporting the problem);
- monitoring, conceptualization of effect, evaluation of its scale and intensity, identification of losers and winners with the given specification of rights and liabilities;
- appearance of the interested agent-party (having financial interests or public interests), which comes up with a solution of a problem (possibly, in its own future behalf);
- creation of coalitions for/against the solution of the problem and mitigation of the effect, or, on rare occasions, enthusiasm about a common approach;
- recruiting followers in "for" and "against" coalitions, development of approaches and compromises inside the coalitions (two or more, exclusive of unanimous decisions);
- negotiations and conclusion of a treaty between the parties, ensuring abidance by the new rules (for the period of the treaty<sup>9</sup>).

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<sup>8</sup> Obviously, these external effects (externalities) can have "internal" nature, too: some problems stem from the internal development or the arising imbalance of external impacts and the standing of the object (country, ecosystem), or are a side-effect of relations between the object and its system. E.g., the imbalances in the financial system of the USA can produce external effects, influencing the majority of countries, however, this global effect impact the USA themselves.

<sup>9</sup> Some of these decisions survived for centuries: (The Westphalian system), 30 years ("the gold standard"), over 40 years (OPEC as an additional oil market regulator).



Obviously, the idea of creating a global government is not taken seriously (at the present stage of the history of mankind) - this would be the "easiest" solution of all global problems. Let's picture the joint global budget and the process of its distribution for current needs and investments, social assistance, regional equalization and development, climate preservation and global energy modernization. There are two extreme ways of decision-making: authoritarian and democratic. In the first case the source of authority remains unclear (at any rate, of legitimate authority) and it is easy to envisage the scale of complaints from all countries and regions of the world addressed to central executive and legislative bodies. Since such distribution is extremely difficult to perform even within one country or a group of countries with sizable regional inequalities (like Russia or the UN), applying it on the global scale is next to impossible<sup>10</sup>.

Historically, we could consider the ultra-liberal alternative of a world open to separate activities of agents (actors), ranging from individuals to companies and governments. Nevertheless, the history of the 20<sup>th</sup> century showed a pragmatic way to address certain problems, which consists in the creation of various international institutions. Among the factors of their emersion and development we can enumerate:

- significance of the problem for the global community and separate interests groups;
- composition and influence of interests groups;
- the extent of public awareness of the global problem;
- the balance of compulsion momentum and regulation complexity;
- the possibility to split up stakeholders' interests.

In principle, the externality can be internalized by means of creating the corresponding institutions. Generally speaking, the evolution of institutions, including property rights, is closely connected with the need for internalization of externalities (Demsetz, 1967). This is thoroughly studies within a separate jurisdiction. But even on such restricted scale the problem of emergence and internalization of externalities remains intricate, since both the processes in itself and the result of combating the manifestations of an external effect can originate new externalities (Tullock, 2011).

It is even harder to ensure correct operation of institutions in the limits of global economy, especially, due to the inhomogeneous distribution of losses inflicted by external effects,

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<sup>10</sup> However, the degree of regional inequality in Russia is comparable to the inequality of UN member-states (including, arguably, institutional dissimilarities).

information asymmetry, uncertainty of regulation measures, prevention or adequate compensation of losses and assessment of their volume. Though, obviously, the main thing is the absence of a direct connection between title to assets and liability for the consequences of economic and other activities, strongly marked in the international sphere. A plethora of independent (sovereign) jurisdictions, dissimilarities of property rights systems, legal frameworks and huge costs involved in the settlement of economic disputes (e.g. processes within the WTO), uncontrollability of certain spheres of activities and non-execution of court judgments, whose authority is disputable, sizably hinder the formation of an optimal structure of the respective institutional mechanism.

The specific character of the global external effects can be attributed to the absence of a homogeneous institutional environment on the global scale (and, in fact, the absence of the global government), which impedes the formation of unified global rules, and, more importantly, universal mechanisms of enforcement (Furubotn, Richter, 2005). Ideally, a new, more complex and dynamic world will bring forth a new system of regulation and partnership.

Rischarde wrote: "Tomorrow governments (federal, regional and local) will be unable to single-handedly address complex issues without strong assistance from the other two social sectors. A completely new reality is emerging: a partnership of politics, business and civil society. In the two coming decades this trilateral partnership can be expected to flourish at all levels - global, regional and local" (Rischarde, 2003).

This optimistic view did not prove out, at least in the first decade mentioned by Rischarde. Apparently, we are dealing with complex processes, where the pace of change, volatile interest (especially in the times of the global financial crisis and sizable structural shifts) do not allow all partakers of the regulating process to easily establish partnership. Reaching a compromise and mutual understanding during tranquil periods of development, not market by significant changes, is much easier not only because the actors are not feeling threatened by the looming political, economic or moral bankruptcy. The anticipation of changes, difficulty in predicting the behavior of rivals and partners are of greater importance. The potential threat of bankruptcy, private risk assessment can result in the states' and companies' negative evaluation of partnership expediency. Civil society can also have various judgments of its standing, interests, objectives and preferences depending on the condition and dynamics of the environment (and other partakers' activities). The problems of democracy, justice inside or outside the country, as well as global problems might be in the focus of attention. The priorities and objects of concern are shifting. Consequently, the theory and

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practice of global governance cannot proceed from the constancy of interests and compromises.

Emphatically, there are dissimilarities in the partnership of three main groups of actors (government, business and civil society) in different spheres. In our opinion, civil society could cope with many functions better than the state, but the latter is not always ready to disclaim them; moreover, not all layers of society are willing to take a risk and get out of the state's tutelage. All types of governance are specific in their own way, have their upsides and downsides, for which reason it is difficult to unite the corresponding actors in a coalition.

Strictly speaking, the very process of formation (including negotiations) of global governance institutions is associated with transaction costs, possibly, of prohibitive volume, which in this case is connected not only with the awareness or intellect of the parties, but also with the dissimilarities of interests (priorities in the system of resolving national and global scale problems). An example of the above is the intricacy of negotiations on preventing climate change (Makarov, 2011). There are number of global externalities, which in the short and medium perspective can bring on so much larger social costs and threats to sustainable development, that they exceed transaction costs of regulation for every participant of the process. Here a solution can be found on the analogy with those framed in creation of the system of contracts during the "cold war", which helped to prevent a global conflict.

## **5 In pursuit of a solution: key crossroads**

In the absence of a homogeneous institutional environment, there is an automatic increase of transaction costs of economic agents' interaction. It is much more difficult to address global and national problems transcending national borders, at the global level amid a heterogeneous institutional framework, both formal (legal) and informal, than within one country and its legal regime.

Following the conclusion of the Coase theorem, the efficiency of the final allocation of resources depends on the initial distribution of title to them and the costs of their redistribution. On the global scale it is even more explicit, as the costs of international property rights transfer are extremely high, correspondingly the transfer of assets to a more efficient owner, ready to pay for them, is impeded.

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*The first problem*, stemming from the attempt to create an economically efficient mechanism of global governance is *the specification of property rights and the supervening liability for addressing global problems*. The latter may affect national economy and public welfare; they reflect the risk of future costs or need settling according to humanitarian reasons (poverty, biodiversity, human rights etc.).

In distribution of property rights the following questions have to be answered: who and within what authority do air, the ocean and mineral resources belong to; who holds the right to set currency exchange rates and the rules of transit through the territory of third countries; whether the poorest countries are entitled to a compensation for the events of remote past (if yes, than, to what extent) etc. In this regard property distribution represents not only the appointment of the owner of a certain kind of resources, but the distribution of all property authority, i.e. anchoring the rights of all participants of interaction pertaining to control and management of the said resource.

The specification of property rights does not necessarily ensure access to resources for efficient owners (inside the country and in other jurisdictions) for the production of goods with minimum costs. However, it is the necessary condition for providing such access, as it creates the background for the exchange of rights.

Following the logic of Coase and Pozner, the legislator has to set the most efficient distribution of property rights (Pozner, 2004. V. 1. P. 67-74). At the same time in practice the specification of property rights is governed both by redistribution rationale and value factors (Calabresi, Melamed, 1972). Instead of a legislator, "historic accidents" prevail in global economy - they are after-effects following the emergence of states, wars, conclusion of treaties. In most cases there are no unified constitutional rules. As a result, the distribution of property powers on the global scale is associated with sizable transaction costs, and there is no guarantee, that the rights will be transferred to efficient users. In fact this inflicts additional legal costs - the so called "unfavorable investment climate".

The specification of property rights implies fixing certain agents with costs and liabilities. The result is, once property rights of every participant of interaction have been determined, overstepping the boundaries of these rights (e.g. discharging hazardous substances in the "common" or "somebody else's" ocean) will entail liability and costs to compensate this impact (another question is, whether these costs will actually be incurred). However, even the prospective liability and costs do not guarantee taking cognizance of long-term effects,

say nothing of external effects remote in time and distance. Economic agents optimize their activities at the micro-level, so as to comply with the legislation and rules of their jurisdiction within certain limits, but possibly with no regard of remote effects.

The intricacy of property rights distribution at the international level stems from the absence of an "absolute boundary" between economic activities inside a country, a group of countries, legal area (e.g., the European Union) and global economy on the whole. For this reason, international distribution of property rights is "superimposed" on national distribution with "two-storey" problems arising. Thus, the distribution of rights to greenhouse gases emissions between the countries is "superimposed" on the principles of distribution inside every country. If the country does not have internal procedures for property rights distribution regarding certain resources or goods, its participation will also impede operation of the international market. At the same time, such procedures may be in conflict with the procedures used in countries, or with the practices of the international business conduct.

This can be exemplified by the situation in the European aviation sector in 2011-2012. European regulators demanded that air companies of all countries, including those, not holding membership in the EU, purchase greenhouse gases emissions quotas in compliance with the European procedure of quotas trade applied to flights to European airports. This resulted in violent protest from air industries of the USA and China. In our context, this was an attempt of one jurisdiction to impose its internal rules of resolving a common problem on economic agents from other jurisdictions.

Property rights distribution (and the consequent distribution of liability) at the international level does not necessarily imply a decision of a supranational regulator. Economic agents can freely, without any enforcement on the part of a supreme planner, transfer the ownership of resources to private, governmental or communal regimes of property (Ostrom, 1999). The initial distribution of property rights on the global scale (as well as at the local level) is carried out in the frames of the model, described by Buchanan: economic agents grasp all property rights they can, until faced with interests of other stakeholders (Buchanan, 1975). This stage is marked by the conclusion of the so-called constitutional agreement, stipulating property rights and preventing their unwarranted redistribution.

Presently the formation of a global constitutional agreement is unlikely, but similar agreements are concluded pertaining to specific problems<sup>11</sup>. This can be exemplified by agreements under Kyoto protocol and other systems of quotas trading in regard to greenhouse gases emissions, which make provisions for the specification the respective powers, moreover, a double mode is applied: country - enterprises-emitters. After that property powers can be exchanged between countries and agents inside the country.

The specification of property rights (liability) with the subsequent market exchange is far not always sufficient. Thus, addressing a number of global issues is not limited to the production and distribution of private amenities, while commons require a different approach. Let us give a generalized formulation of the problem: transaction costs of the price mechanism may be too high (market failure on the global scale). In this case market coordination will be inefficient and a different regulation mechanism may be necessary.

*The second problem is the choice of the optimal mechanism of transactions governance necessary for shaping the mechanism of global governance at the "operational" level. We are referring to the pursuit of the most suitable combination of the hierarchical, market and hybrid modes of transactions governance in solving separate global problems.*

For greater clarity let's picture a "biblical story of regulation". Let us say, that at some time on our planet there were no sovereign states, diverse legal regimes and significant heterogeneities of development - a kind of "institutional paradise". Under such conditions transaction costs were kept down to a minimum, development momentum was optimal, the distribution of resources was more or less homogeneous, property rights and contractual rights were fully observed. But for "the sins of economists" the Providence expelled the humanity from this paradise by bringing in extreme inequalities in development and natural resources distribution. Moreover, it also introduced sovereignty and state boundaries with dissimilar formal and informal institutions, and addition - drastic (though secondary) differences in development priorities, lifestyle, ethics etc. This modern situation is the background for the backward reduction of transaction costs, bridging development obstacles by selecting the appropriate (not ideal, but a functioning one) system of economic relations

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<sup>11</sup> In this case a constitutional agreement does not literally denote an introduction of a global "constitution", but a substitution of such treaty in the private sector - a set of formal and informal rules regarding certain resources.

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regulation pertaining to the transfer of property rights (transactions) for every sphere of human activity.

Transaction cost economics generally implies three modes of transactions governance. *Hierarchical* regulation suggests an asymmetric position of contract holders, where decisions about transactions are made solely by one party. *Hybrid* regulation enables both parties to participate in decision-making by means of negotiations (a bipartite mechanism) or by engaging an intermediary (a tripartite mechanism)<sup>12</sup>. The hierarchical and hybrid modes of regulation involve long-term continuous relations as well as interdependence of the parties. In the event of *market* regulation independent parties freely switch between counteragents in the absence of special procedures of disputes settlement (either there are no disputes or their settlement does not present any considerable difficulties).

The choice of a mechanism of transactions governance is closely linked with the analysis of their characteristics. Among these characteristics, Williamson distinguished the frequency of the transaction, the specificity of its object and the degree of its uncertainty (Williamson, 1979). Yet, in fact the key criterion is the need for adaptation of transaction parties, which is carried out by means of a mechanism or market prices, or direct coordination.

Apparently, with a low specificity and/or frequency of transactions the choice of an alternative counteragent is associated with lower costs: in this case, it is possible to immediately switch to a different partner, as there are many options in the market. In this case, economic agents can be guided by the price mechanism, for it allows to efficiently *adapt to the market*. However, if resources (objects of transactions) are highly specific, i.e. finding a different counterpart is difficult, while transactions have to be carried out frequently, then stakeholders have to adapt directly one to another, since transition costs are too high. Here direct coordination is preferable, implying adaptation of counterparts to one another, and not to the market.

In selection of the price, mechanism market regulation of transactions is applied, while regulation of direct coordination tends to hierarchical structure: in this event adaptation costs

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<sup>12</sup> It is assumed, that an intermediary is chosen voluntarily, though there are cases, when one jurisdiction, country or a group of countries announced this or that sphere of global economic (natural, geographic) life the area of their strategic interests. Thereby either "external regulation" of transactions or compulsory arbitration in the said sphere were imposed.

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will be minimal, since the process of issuing and executing commands in the frames of hierarchical structure does not suggest either negotiations or switching to other counterparts. In intermediate situations, the parties will opt for hybrid regulation. In an ultimate situation there are two alternatives: one of them is liberalization of goods and inputs transfer in the context of "ideal" global regulation; the other - a global government, and, in fact, a global Planning Committee.

The idea of preferred adaptation of a certain kind can be applied to any situation. For example, an endangered plant only grows in one country and is of value only for one foreign company; it is preferable to establish a hierarchical international structure, based on long-term cooperation and centralized control, because if one party withdraws from contractual relations, this will be ruinous for the resolution of the problem. But if the plant is to be found in many countries and is supplied to a number of companies, then a competitive market mechanism can be used, which automatically remunerates the country and the company, who will manage not only to preserve and use the plant, but do it in the most efficient way.

The mechanism of regulation employed in a particular sphere is not necessarily the same. An intriguing example of the development of global regulation mechanisms is the global oil industry.

In the middle of the 20<sup>th</sup> century western oil companies and governments of oil-producing countries cooperated on hybrid basis - long-term bilateral negotiations. In the 1970-1980-s, there were changes to international mechanisms of regulation applied to this industry. Due to nationalization of oil-production enterprises in a number of countries in the 1970-s considerable amount of world oil reserves were centralized in the hands of national oil companies. States (and their national oil companies) could dispose of oil as a 'non-specific' asset. In the context of high and still growing demand, it could be sold to a wide variety of competing buyers. The market mechanism of transactions regulation turned out optimal for the producers, since oil traders, independent from western companies, could choose the most profitable buyer.

Due to further oil price increase, which made even it profitable to produce oil even at complicated oil deposits, as well as due to discoveries of new fields, alternative manufacturers entered the oil market, including the North Sea countries and the USSR. Buyers were enabled to switch between traders. Against the reduction of oil consumption in the 1980-s this implied an upswing in demand for market mechanisms on the part of oil



consumers. At that moment, the replacement of older transactions regulation mechanisms with market mechanisms became inevitable.

Above we gave a list of the most frequently occurring mechanisms of global regulation. According to Williamson, a corresponding regime (mechanism) of transactions regulation can be assigned to each of them (Williamson, 1996):

- a) an international organization, independently disposing of resourcing for reaching its objective - the hierarchical mechanism;
- b) an international organization, acting as an advisor and arbitrator - the hybrid (tripartite) mechanism;
- c) international bipartite agreements without a specialized oversight organization - the hybrid (bipartite) mechanism;
- d) international multipartite framework agreements - the hybrid (bi- or tripartite) mechanism;
- e) network organizations of the civil society - the hybrid (bi- or tripartite) mechanism;
- f) clubs, groups of countries, sharing mutual interests - the hybrid (bi- or tripartite) mechanism;
- g) absence of specialized regulating organizations and long-term agreements - the market mechanism.

The table below lays out the general characteristics and examples of various mechanisms of transactions regulation with the participation of governmental or private economic agents.

The answer to the question of property rights specification in the context of a particular problem, as well as to the question of a mechanism of transactions governance allows the draw up a "menu" of institutional options of global governance mechanisms, which mentioned above in this article, and give basic comments to the selection of options.

**Table 1. The regimes of international transactions governance at the level of state and private sector**

	Market	Hybrid	Hierarchy
States (governmental authorities)	States act as independent market participants (example: government bond market)	There is a long-term interdependence, bi-, tri- or multipartite regulation mechanism (example: regional unions, the EU on the whole)	States delegate decision making either to one of them, or to a supranational party, the authorities of other countries abide by their rules (example: the countries of Euro area in the sphere of monetary policies)
Companies (private sector)	There are independent private buyers and vendors (example: the greater part of international goods and inputs markets)	There are autonomous but interdependent agents on the basis of long-term agreements (example: international chains of value creation in the context of long-term cooperation)	The central agent controls the activities of individuals and institutions in different countries (example: transnational companies)

Let's exemplify this.

In the spring of 2013, there was much talk about an investigation, conducted by the International Consortium of Investigative Journalists, which resulted in the disclosure of certain data about a number of offshore transactions performed by high-ranking politicians of many countries in the British Virgin Islands. The wording of the global problem can be as follows: due to the existence of offshore zones, not only providing tax benefits, but also allowing to disguise information, transactors from all corners of the world can perform their shadow operations there. This impedes the functioning of states, including law enforcement agencies. It also globally limits voters' access to information – a global externality is produced.

For internalization of the described effect, property rights have to be defined first. Whether international norms entitle "offshore" islands to provide secrecy of all transactions? If yes, i.e. the rights to dispose of the information are fully relegated to the islands, then, the global community can pay them to waive this right and disclose the information. Accordingly, such disclosure will depend on whether the stakeholders will be able to raise the finances to compensate the waiver of the right. At first the idea of such compensation may seem unusual, but in the context of offshore islands' financial difficulties, e.g. during a crisis, it is possible. However, in this case the states might be faced with the problem of collective actions: far not all of them are willing to pay for the disclosure of offshore information, while some states will sooner additionally pay for the preservation of secrecy. If a common

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international decision is taken, stipulating, that "offshore" islands are not entitled to secrecy, the information can be subducte (yet, they may claim a counter-compensation, which though seems unlikely).

Whilst property rights (in this case - property right to secret information) are undetermined, the disclosure of information will be occasional and will not resolve the problem. None of the parties will have confidence about the disclosure of information, or, vice versa, preservation of secrecy. As a matter of fact, for this reason namely the journalists did not disclose the entire information - they could have faced legal risks.

Next question is the choice of a mechanism of transactions governance, in particular, in application to payments for information, if required, for its disclosure and transfer in every case of property rights distribution. The hierarchical structure can be employed - let us say, a specific international regulatory body similar to FATF, which will be authorized to investigate and make public all "offshore affairs". A market mechanism could be used: i.e., announcing, that via a certain procedure all interested parties (probably, with a number of restrictions, but at least, this would include governmental and parliamentary officials, mass media, international organizations) have access to the documentation of financial deals in offshore territories. In this case, the stakeholders will act independently.

Then, with low transaction costs, it is possible to achieve the level of information proximal to the optimum. In other words, if a market mechanism is applied, then, all information which disclosure is deemed efficient (from the standpoint of social benefits and costs), is likely to be disclosed. Yet, the scale of disclosure will be governed by the balance of private benefits and costs - e.g., the rich will have more opportunities for control. This drawback can be partially eradicated by using a hierarchical mechanism - a special organization. Yet, their incentives have be to such that allow to avoid the problem of a principal-agent. A hybrid organization can be created, let us say, a network of national anti-offshore independent services.

Due to the peculiarities of transactions, agents are forced to select institutions enabling them to govern the said transactions with minimum costs: in fact (on condition of successful negotiations), they manage to achieve a minimum possible discord pertaining to the procedure of transactions. Needless to say, the parties' assessment of profitability of such treaties may change with time.

Institutions are in *demand* with the agents, but there also exists a problem of *supply* of institutions. The latest is understood as the ability not only to come up with the rules of regulation, but also to enforce them. One of the peculiarities of global regulation is the absence of a formal guarantor at the global level. This, naturally, does not mean that enforcement is not possible in international relations: Furubotn and Richter give a number of methods of international treaties protection both on a bi- and multipartite basis, including bonds exchange, agreement termination threat, reputation costs, support of treaties by a hegemon-state etc. (Furubotn, Richter, 2005).

Both states and private companies can participate in the supply of international institutions. Yet in the second case some problems arise, which in theory ascend to the scope of organizations and group interests (Olson, 1965). If the object of a transaction are commons, with a comparatively large group of stakeholders, and a number of agents (states) are privileged from the standpoint of violence potential (as compared to individuals and organizations), then the costs of private guarantors can turn out to be too high relative to the benefits. This is where states return to the foreground.

*The third problem*, closely connected with the first two, is *the mechanism of expansion of the established institution*. This expansion can be achieved using mechanisms of the institutional or political market (Tambovtsev, 2005). In the case of institutional market, every agent can choose between alternative institutions: an example for interstate economic relations is the regime of the WTO, which makes provisions for voluntary entry (but with a complicated system of admission on a consensus basis). In the political market institutions are imposed by a regulating body - its guarantor - on all agents, performing activities in a certain sphere, while the objects of this rule themselves can influence decision-making using their negotiating power.

A vivid example of such interaction was the situation in Libya: violent suppression of civil commotions by sovereign state authorities, which transgressed the rules of western society, lead to sanctions on the part of the latter, up to armed intervention. Another example of various methods of institutions expansion is the single-handed adoption of the "gold-standard" by the developed countries at the end of the 19th century, which illustrates the institutional market; post-war centralized introduction of Bretton-Woods system, as an example of the political market.

*The fourth problem is ensuring feedback and mechanism correction.* Does the method of addressing a global problem, selected by the international community, meet the expectations? Are the existing mechanisms adequate for the current needs of the global community? These questions are topical due to institutional inertia: an inadequate mechanism will not be automatically edged out, at least, it will not disappear in a historically short term, on the opposite, it will create the threat of getting into an institutional trap. In this context we can mention the shortcomings of the UN, and, in particular, the Security Council, inadequate distribution of votes in Bretton-Woods institutions, an obvious lack of "capacity" of organizations, dealing with poverty, biodiversity, climate and destined to prevent and minimize losses of the civil population during local conflicts.

Analyzing and establishing the mechanism of addressing global problems, emerging in the global economy, suggests:

- revealing the characteristics and parties of the produced external effect;
- determining the existing property rights (and liabilities), if present, and identifying the possibilities of their specification, if absent; otherwise - redistribution of rights with a view to reduce the access costs for efficient agents;
- identifying the parties and characteristics of entities, benefitting or incurring losses in every redistribution of rights;
- considering alternative mechanisms of transactions governance for internalization of externalities, fostering public welfare;
- studying ways and perspectives of expanding sustainable institutions, involved in establishment (redistribution) of property rights and creating a mechanism for transactions regulation;
- pursuit of possible mechanisms of enforcement in the given international relations;
- selecting mechanisms of feedback and correction of the existing and the suggested regulation mechanisms.

In this article we did not aim at picturing a complete logical system of international governance, as such a study would require analyzing the actions of governments, companies, national elites, which cannot be reduced to the rational logic of minimizing transaction costs of global governance. In fact, the existing regulation systems are a product of the historic process of origination of problems, and their settlement in the ways available to the agents, who, in their turn, are aware of the risks and threats. The political possibility to take rational decisions in economy and regulation is restricted by the existing international

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institutions and interests of the leading countries. The current system of international governance has rational content opposing chaos, reducing costs and gradually shifting to the resolution of pressing problems (global externalities). However, it is imperfect, is subject to challenges, both innovative and opportunist, but this content can be rationally systematized in the language of economic theory, which will allow to raise the question of its optimization.

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