Multilevel Governance in Globalized Industries

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Despite its accomplishments, the literature on multi-level governance displays an unresolved problem that is crucial for the future success of this particular literature and for our understanding of governance and politics more generally: the tension between *functionality* on the one hand, and *democracy* and *politics* on the other. One way of explaining the emergence of multi-level governance is its functionality. For instance it can be argued that traditional state-centric governance was inefficient, and that it is more cost-effective for some of its functions to be delivered at different scales or by the private-sector. However it can also be argued that these shifts are driven by politics, for instance by actors deploying their power to have decisions made and implemented at the scale or in the location that best suits them. In particular, such shifts raise serious concerns about the erosion of the unique capacities of the state, which include not only its ability to manage and integrate multiple functions, but also its status as the most developed locus of legitimate collective action, conflict resolution, and the ordering of political communities—properties which today are closely associated with democracy.

The central argument of this paper is that multilevel governance is driven by the *interaction* between functional imperatives and politics rather than one or the other, and that multilevel governance is essential for the future prospects for democracy, but that playing this positive role rather than a negative one depends on developing better institutional mechanisms for resolving the tensions between functionality and democracy. This challenges the tendency in the literature to see multilevel governance as driven either by functionality or politics rather than their interaction, and to see it as either good or bad for democracy rather than essential but indeterminate.

In this paper I start by further exploring these conceptual issues, but then I assess the relevance of the above argument with respect to a particular industry and policy field: global finance. This paper will show that global finance both involves crucial local and international public policy, regulatory, and organizational issues for which the concept and practice of multi-level governance is ideally suited, and which are useful in exploring the tensions between functionality and politics on which this paper focuses.

Conceptualizing Functionality, Politics and Democracy in Multi-Level Governance

In this section I start by exploring functional explanations for multi-level governance before turning to approaches that highlight the relevance to multi-level governance of politics and democracy. In the third subsection I examine the relationship between these.

Functional explanations

In explaining multi-level governance it is useful to disaggregate its features because they each may be shaped by a different set of factors. One can distinguish between the redistribution of public policy responsibilities across different levels of public sector institutions, such as a shift from national governments to local governments and international inter-governmental organizations, on the one hand, and on the other had a shift from the public sector to non-governmental actors, such as industry associations or networks of experts. A closely related distinction is between what Hooge and Marks (2003) have labeled "Type I" and "Type II" multilevel governance. Type I multilevel governance resembles more closely traditional federalism, with a clear division of responsibilities between multi-functional political units covering relatively well-defined and exclusive territories, while Type II involves overlapping and more diffuse networks consisting of institutions and actors that each tend to focus on particular functions.

One type of functional explanation emphasizes economic efficiency. Efficiency considerations can explain shifts towards both Type I and Type II forms of multi-level governance. In the former case the optimal scale for the provision of public services may vary, with for instance education best provided at the local level and airline regulation at the national or international levels. In the latter case the drive for cost-effectiveness has often been cited as a reason for shifting functions initially provided by national governments to private-sector actors.

A second type of functional explanation that has not received nearly the attention it deserves is rooted in sociology and a particular tradition of studying international institutions that was popular in the period after World War II. This approach identifies a long-historical tendency for societal functions to become more differentiated and autonomous over time.[1] Thus as the state evolves one might see a tendency for ever more specialized ministries to be created. In contrast to economic efficiency explanations many of these specialized functions might forcefully exclude efficiency as a consideration, for instance in jurisprudence where judgments are based on legal principles rather than cost-benefit calculations. At the international level this type of functional explanation was used by Mitrany (1975) and others (Tranholm-Mikkelson, 1991) to explain the creation of functional international organizations such as the World Health Organization, and functionalists like Haas also sought to explain early European integration by arguing that a focus on functional projects that cut across territorial boundaries, such as the revival of the coal and steel industries, could shift policy processes away from their exclusive focus on competitive territorial states. While this type of functional explanation has rightly been criticized in the past for not adequately considering contingency, reversibility, politics, and agency, significant progress has been made in addressing these problems conceptually.[2]

In contemporary multi-level governance a shift from Type I to Type II arrangements could be seen as involving functional differentiation that goes beyond efficiency considerations. For instance the need to develop and make use of highly specialized and relatively self-referential bodies of expert knowledge to solve particular technical problems (such as the risks of bio-technologies) may lead to the creation of relatively autonomous cross-border networks of experts. While one might be able to interpret this differentiation as driven by the greater costs of trying to manage diverse bodies of expertise in a single organization, these costs are only

[1] For a discussion of functional differentiation and references to the literature see Porter (2005b). See also Blatter, 2004. For a related use of a "differentiation thesis" see Eberlein and Grande, 2005: 93.
[2] See especially the work of neo-functionalists such as Alexander (1985) and Niklas Luhmann.

understandable with reference to the distinctive character of the communications codes involved, which in turn stem from the interaction of these codes with the problem-area with which they primarily interact.

This broader concept of functionalism can be usefully applied with reference not just to expert knowledges, but to the physical properties of technologies.[3] Technologies are simultaneously bodies of knowledge and material artifacts, and the autonomy and logic of the former combined with the constraints associated with the latter can help explain the way in which industries are organized and governed. To take an obvious example, short-term automobile traffic problems are likely to be addressed by local government, while short-term solutions to airline security threats are more likely to be organized internationally, and these in turn are related to differences in the technologies associated with the two industries (traffic lights and road travel vs. internationally-shared no-fly lists and cross-border air travel for instance).

Politics, Democracy, and Multi-Level Governance

There are sharp disagreements about the relationship between politics, democracy, and multilevel governance. Political explanations for multi-level governance are closely related to these differing assessments of its consequences for democracy. If multi-level governance is seen as the political project of powerful elites or business groups then it is likely to be seen as negative for democracy, while if it is seen as a response to popular demands for new and more disaggregated policy arrangements then it will be seen as positive.

One reason that multi-level governance may be positive for democracy is that it provides more access points for citizens, including through dispersed networks. Such networks may encourage the deliberative aspects of democracy, in contrast to the excessively formalized character of traditional policy processes (Neyer, 2003). To the degree that functions are shifted downwards, as in the principle of subsidiarity, government might be brought closer to the people. For those who see centralized governments as inherently threatening to democracy and who applaud markets as a corrective, Type II multi-level governance is especially beneficial since overlapping institutions that focus on single functions can create competing arrangements that citizens can choose between (Frey and Eichenberger, 1996).

There are a number of ways in which multi-level governance has been seen as negative for democracy. One major problem is the difficulty in holding policymakers accountable when responsibility for carrying out public policy functions is spread across levels, diffused in networks, or handed over to experts or business actors.[4] A second and related major problem is the damage done to the power and capacity of the state (Harmes, 2006, Morgan, 2003), which for these critics is seen as the best vehicle for taking collective action, resolving political conflict, and engaging in the practice of democracy.

The relationship between functionality, politics and democracy in multi-level governance

There are at least two indications that compatibility between functionality and democracy cannot be assumed. One is the common argument that there are certain functional imperatives that need to be addressed by experts or diplomats and therefore cannot or should not be brought into

[3] On this approach to technology see Porter, 2003 and Levi-Faur, 1999.
[4] See Peters and Pierre (2004). Anderson (2006) for instance provides evidence that voters are less able to hold authorities accountable on economic matters in multi-level systems.

processes of democratic deliberation and accountability. This is the logic associated with making central banks independent, for instance. In the case of multilevel governance, perhaps its complexity is an unfortunate necessity considering the complexity of the environment in which it operates, and the damage this complexity does to democracy must simply be accepted. A second indication that compatibility between functionality and democracy cannot be assumed is the critical response to the first. This critical response argues that functionalist arguments simply mask political self-interest, as expressed in the view that the migration of policy decisions to informal networks, while justified on grounds of policy effectiveness, instead is designed to secure the self-interested dominance of those policy decisions by business and well-paid experts at the expense of the general public.[5]

This paper pursues an alternative approach that suggests that functionality and democracy are both important, are in tension in both of the ways identified in the previous paragraph, and that the solution of this problem is increasing the involvement of the public in decisions about the distribution of policy processes across levels of governance, an increase that can be labeled the democratization of meta-governance.[6]

The paper's arguments can be summed up in the form of two contestable and related propositions:

1. The development of multi-level governance is best explained as involving the interaction between functionality and politics, rather than being driven purely by functional factors such as efficiency, or by politics.

2. The tension between functionality and politics will be most effectively resolved by democratizing meta-governance rather than by dismissing functionality as political rhetoric or by insulating functional processes from democratic processes.

Multiple Levels of Governance in Global Finance

In this section I start by establish the degree to which global finance is governed at multiple levels.[7] A key feature of this analysis will be the identification of multiple levels of private governance which are entangled with multiple levels of public-sector governance. In discussing *levels* reference will be made both to different scales (ie. to differences in spatial domains) and to different levels of authority (ie. where one level is subordinate to or nested within another).

Private-Sector Multi-level Governance in Global Finance

To some degree private sector governance in finance corresponds to the familiar nested hierarchy of local, national and supranational. However while the local is very much rooted in particular places, such as the City of London, Wall Street, or other smaller financial districts, these tend to have functions that orient them towards much larger scales, and indeed they compete to become nodal points in national or global financial systems (Thrift, 1994).

[5] For a related argument see De Goede (2004).
[6] On meta-governance see Jessop, 2003, 2004.
[7] More information about the institutions discussed in this section can be found in Porter (2005) or through Google.

There are two main types of place-based local governance arrangements in which private-sector actors are prominent. The first are coalitions to promote financial districts.[8] These go far beyond marketing since they involve themselves in trade, regulatory, tax and other policies. The most important such coalition is International Financial Services London, a private-sector organization with British and foreign financial member-firms and public sector representatives, which states that:

> IFSL works for the removal of barriers to trade in the global market for financial services…IFSL is engaged in major initiatives to help ease regulatory and other constraints...IFSL played an important role in the negotiations which led up to the 1997 Agreement on Financial Services under the auspices of the World Trade Organisation. (www.ifsl.org.uk/about/index.html).

IFSL is locally oriented towards the City of London, but considering the thoroughly multinational character of the firms in the City and the eagerness of the government of the UK to work to promote their interests in the City's global character, IFSL is in effect one of the most important examples of the role played by the private-sector in global financial governance. A similar but less global example is the Toronto Financial Services Alliance (TFSA), which states that it is "a unique public / private initiative of individuals representing the financial services industry and its trade associations, all levels of government and academic institutions. Its mandate is to enhance and promote the competitiveness of Toronto as a premier North American financial services centre" http://www.tfsa.ca/about/

The second type of place-based local governance arrangements in which private-sector actors are prominent are financial exchanges. All market architectures require some mechanism to centralize transactions sufficiently to foster price competition, and in the case of financial transactions, with their relatively intangible character, this has involved the physical construction of financial exchanges in particular places, such as the New York Stock Exchange. Traditionally such exchanges have been organized as private-sector clubs with an important self-regulatory role, backed up by public sector rules such as licenses required for brokers to engage in trades. While stock exchanges are the most familiar, other financial exchanges follow this pattern. For instance Lloyd's of London, a private-sector market, governed the global property and casualty insurance industry for centuries.

While the local place-rooted character of financial centres can be traced to the intense need for face-to-face coordination and social-cultural mechanisms for fostering trust in international markets of intangible products, there has been a marked shift away from reliance on place that has accompanied the globalization of finance in recent years. The global orientation and reach of IFSL is one example, but exchanges have also been transformed. Distant foreign investors are comparing one exchange against another and electronic trading technologies have increasingly eliminated the need for a trading floor. These changes have undermined the social cohesion of exchanges that was important for their self-regulatory capacity, and made members have begun to see the self-regulatory aspect of their membership as an unwanted cost. In response to these changes the industry has experienced a wave of demutualization in which exchanges have been transformed from non-profit clubs into profit-seeking firms. By 2006 19 major exchanges had demutualized, including the New York Stock Exchange, and the demutualized model had become dominant globally, although demutualization was much less advanced in the developing world (IOSCO 2005, 2006). In some cases the exchange's regulatory

[8] There are some similarities between this and the more general "regional foresight exercises" discussed by Gertler and Wolfe (2004).

function has been spun off as a regulatory services firm, and in other cases it has been picked up by public-sector regulators.

At the national and supranational levels private-sector governance has also become more functionally and globally oriented. Traditionally the financial industry has had strong national associations organized by sub-sectors such as banking, securities, insurance and accounting. These associations' governance roles included lobbying their national governments, but they also often set standards for their own members, including codes of conduct, professional designations (eg. the Certified Financial Planner designation managed by the CFP Board), and operational rules such as accounting standards. These national associations continue to exist, and they have become more involved with global issues, for instance in sharing lessons with their counterparts in other countries, or lobbying their governments about trade policy or global regulatory standards, but they are now increasingly complemented or displaced by supranational private associations. For instance in recent years the CFB Board has transformed itself from a US-based organization to a global one. National associations, with their large number of smaller locally-oriented member firms may be poorly suited to many issues concerning very large internationally active financial firms or individual professionals, which then construct more specialized multinational associations at the global level.

Two of the most important global private sector associations are the Institute of International Finance and the International Accounting Standards Board (IASB). The former bills itself on its website (www.iif.com/about/) as "the world's only global association of financial institutions…Today the Institute has more than 320 members headquartered in more than 60 countries." Created by leading commercial banks in 1983 to coordinate their responses to the developing country debt crisis, it has expanded its membership to other types of financial firms, and it has become the primary interlocutor on policy matters with the International Monetary Fund and with international groupings of regulators, such as the Basel Committee on Banking Supervision. The IASB has been very successfully promoting the creation of global accounting standards as an alternative to national ones, especially the US Generally Accepted Accounting Standards, and the new international standards have become accepted by governments in very large number of countries, as well as by the European Union. Leading internationally active financial firms also are involved in other global associations involved in global governance, such as the Wolfsberg Group, a dozen top banks which concerns itself with money laundering regulation issues, or the Financial Leaders Group, top financial CEOs that work on trade liberalization issues at the WTO. Financial business leaders also work with their counterparts from other industries at the International Chamber of Commerce. In addition to promoting trade and investment liberalization the ICC plays a role in the documentation of trade finance through its Banking Commission.

In addition to the private-sector institutions discussed so far, which can be arrayed along a local-national-global continuum corresponding to and interacting with Type I public sector multilevel governance, there are a wide variety of private-sector institutions that are more functionally oriented and that correspond more closely to Type II multilevel governance. To some extent these too can be differentiated by scale and levels of authority, with the global becoming more important in recent decades. Indeed some of the associations already mentioned could arguably be characterized as functionally-oriented ones. For instance the Wolfsberg Group or the IASB, while addressing systemic multi-industry issues associated with money laundering and accounting, also focus in on technical specific coordination tasks. In a recent study the number of financial associations that were active internationally was found to be approximately

225.[9] Most of these are quite focused on the needs of a particular industry segment rather than governance in finance more generally, such as the International Cooperative and Mutual Insurance Federation, and as such can be considered to be functionally oriented.

The more functionally-oriented associations are especially prominent at a scale and level of authority not yet mentioned: the regional one. Of 225 internationally active financial associations only 107 are primarily global and the rest are more regionally oriented. Of the regional associations 40 are Europe-focused and the rest are focused on regions in the developing world. The African Insurance Organization or the Latin American Confederation of Savings and Loans Cooperatives are examples. No significant North American-focused financial associations exist. The character of these regionally-oriented associations varies in a way that reflects the character of the region itself. For instance the European-focused associations engage in sustained EU lobbying in Brussels, while associations in the developing world's regions are more likely to be focused on helping their members compete by sharing information, and their interaction with the public sector is more likely to be a two-way relationship with global institutions such as the World Bank or the International Organization of Securities Commissions where they seek to exercise some influence but also draw on the resources and rules of the global institutions to bring their members closer to the level of functioning of firms in other regions. In the case of financial exchanges, the World Federation of Exchanges maintains close relationships with six regional associations of exchanges.

While associations are the type of private-sector institution that is most clearly involved in the governance of global finance, there are other important ways in which the private sector is involved in governance. These include credit-rating agencies and other "coordination services firms" which can bring intense market discipline to bear as a result of the way in which their interpretive models judge the performance of states and corporations (Sinclair, 2005). They also include business practices, some but not all of which are codified by associations. An example is derivatives contracts, some of which have become sufficiently routine to be codified by the International Swaps and Derivatives Association as a "Master Agreement Protocol". A third type of institution is practices and rules internal to firms. The most generic of these is corporate governance itself, which involves a blend of public sector laws and internal practices, and while plays an important role not just in the way in which financial firms are governed, but also in the way that securities markets impose market discipline on firms. One might treat market forces in financial markets as a more general and abstract element of governance, although this governance function depends on more identifiable and concrete institutions, and for both pragmatic and theoretical reasons it is best to restrict the concept of governance to recognizable concrete institutions rather than abstract market forces, although the impact of the latter in the former should be recognized.

Public-Sector Multi-level Governance in Global Finance

The public-sector institutions involved in the governance of global finance, like the private-sector ones, display both Type I and Type II characteristics. I start by setting out the way in which public sector governance is distributed across a local-national-global continuum in a way that corresponds to Type I multilevel governance and then I examine the more networked Type II forms of public sector governance.

[9] This study was conducted by the authors of McKeen-Edwards and Porter (2005), which reports some of the results.

While some cities are involved in the governance of their financial districts, as discussed above, in general the smallest scale of public sector governance in finance is the provincial or state levels in federations such as Canada, the US or Germany. For instance in Canada and the US insurance is regulated at the provincial or state level. Key securities regulations are also located at this level. Indeed, since 1919 these regulators have been organized in the North American Securities Administrators Association (NASAA) (www.nasaa.org/About_NASAA). In the US the Federal Reserve, which carries out central banking and regulatory functions, is partially organized on the basis of sub-national regions.

At the national level financial regulation is often distributed across different departments and agencies, although mechanisms for coordinating and integrating these regulatory functions have been increasingly important in recent years. In recent decades the boundaries between banking, securities and insurance industries have eroded dramatically. A common public sector trend has been for central banks to become more independent and focused on monetary policy, with financial regulation being brought together in another independent body such as the Financial Services Authority (FSA) that regulates banking, securities and insurance in the United Kingdom.[10] Other national actors that are important in financial governance include finance and foreign ministries (for instance in trade negotiations) and development agencies.

At the global level there are six formal intergovernmental organizations that are most important in the governance of global finance. The International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development (which plays a specific role in finance through its work on the liberalization of investment, such as the Code of Liberalization of Capital Movements), the Bank for International Settlements, the International Organization of Securities Commissions, and the World Trade Organization (the primary place where financial liberalization is negotiated, and its Trade Related Investment Measures have some impact on the governance of investment flows).

While these formal inter-governmental organizations are important, in the past quarter century more informal groupings and networks have come to play in increasingly important role. A number of these are very technically-oriented groupings of regulators with meetings and a secretariat located at the BIS. The best known of these is the Basel Committee on Banking Supervision (BCBS), consisting of bank regulators from the jurisdictions that are home to the largest international banks. It has created two major agreements that raised the minimum levels of capital relative to assets that banks are required to hold, a way of restraining reckless growth and providing a cushion against insolvency. The Basel Committee coordinates with regional committees of bank regulators around the world. Others such committees include the International Association of Insurance Supervisors (IAIS), the Committee on Payments and Settlement Systems, and the Committee on the Global Financial System. The Financial Stability Forum, created in 1999, also has its secretariat at the BIS, and it is responsible for providing a way to coordinate the work of the other committees and the IMF and World Bank. Coordination between the BCBS, the IAIS and IOSCO occurs through the Joint Forum, also located at the BIS. All these committees minimize the role of politics in their work and try to keep focused on a highly technical generation of best practices.

Two other informal public-sector groupings also play a key role in the governance of global finance: the G7/8 and the G20. The G7/8 is important both when it meets at the leaders' level and at the level of financial ministers. Since it was created in the mid-1970s it has come to

[10] The FSA is an independent non-governmental body with regulatory powers conferred by statute, and accountable to government, but financed by the financial services industry.

informally establish important global policy initiatives, including efforts to strengthen the "international financial architecture" following the global financial crises of the 1990s. The influence of the G7/8 members is sufficient that they are able to implement initiatives both by jointly altering their own practices and through their using their weight in formal intergovernmental organizations like the IMF. It was the G7 that created the Financial Stability Forum, and it also created the G20 in 1999. The G20 involves central bankers and finance ministers meeting informally like the G7/8, but not at the leaders' level. It includes representatives from the G7 countries, along with twelve "systemically important" other countries such as Russia, China, India, Brazil, South Africa, and Saudi Arabia. The IMF, World Bank and the EU also are members. Like the G7 it has no formal secretariat. It addresses issues associated with global financial stability, as well as other policy concerns related to globalization.

In finance public-sector regional arrangements are relatively unimportant as compared to other issue areas or policy fields, and as compared to more global institutions such as those based at the BIS. The exception is the European Union, which has played an important role in the regulation and liberalization of finance within its member countries, but also through its interaction with international processes, such as the BCBS bank capital adequacy standards or the IASB's international accounting standards. The creation of the Euro is an obvious example. Internally, the Financial Services Action Plan, launched in 1999 in order to move "towards a core objective, namely to create a single deep and liquid financial market to serve as a motor for growth, job creation and improved competitiveness in the European economy" (European Commission, 2007: 5) very rapidly implemented close to 40 major measures to liberalize EU financial markets and to create more harmonized regulation. In North America no continental governance in finance exists other than that associated with the North American Free Trade Agreement, especially the remarkably strong investor-friendly Chapter 11 provisions governing investment, but also some minimal coordination through the Financial Services Committee of issues related to the implementation of the financial services part of the agreement. In other regions region-wide financial governance is also relatively insignificant.

One additional feature of governance in finance is the tendency of proliferating bilateral agreements to establish new system-wide models of regulatory collaboration. At IOSCO a series of bilateral Memoranda of Understanding (MOU) designed to facilitate information-sharing in the prosecution of fraud has led to the creation of multilateral MOU with commitments for peer review. Similarly hundreds of bilateral investment treaties with provisions similar to NAFTA's Chapter 11 have begun to establish new investor-friendly customary international law.[11]

This section has illustrated the complexity of multi-level governance in global finance. Both Type I and Type II multi-level governance are evident. Public sector and private sector arrangements interact with one another at various scales and levels of authority. Some institutional actors and mechanisms cut across levels and cannot be located exclusively at one or another. This is evident, for instance, with the IFSL and the governance of the City of London, which is both local and global. It is also evident with corporate governance, which is simultaneously a very local corporation-specific practice, a national set of corporation laws, and a global process of harmonization. While one could say that these operate at multiple levels, they differ from other types of multi-level governance in the degree to which in their ongoing work they cannot be easily disaggregated into distinct levels.

[11] The OECD tried to create a Multilateral Agreement on Investment (MAI) as part of this process but it failed. The bilateral investment treaty process has attained many of the same goals as were motivating the MAI.

Functionality, Politics and Democracy in Global Finance

How then can the complexity of multi-level governance in finance that was set out in the previous section best be understood? This section addresses this question by exploring the relevance of the two propositions that were set out at the end of the conceptual section above, looking at functionality, politics and democracy in turn.

Functionality

Efficiency arguments are very prominent in discussions of global finance. Often they are linked to arguments in support of giving markets a preeminent role in policy decisions. Most experts involved in globally oriented activities, whether in the private sector or public sector claim that regulatory or standard-setting activity does or should support global financial market forces, for instance by correcting market failures with a minimum of public-sector intervention. However while the operation of financial market forces can explain the spread of markets and the difficulty for governments of controlling this spread, and the perceived efficiency gains from markets can explain why governments would support their expansion, such a narrow focus on efficiency has difficulty explaining the complexity of multi-level governance in this area. Even among those scholars who enthusiastic about market-oriented rational actor models, it is now widely accepted that there is no guarantee that efficiency considerations will win out since self-interested actors can engage in rent-seeking or turf-protecting politics as much as they can compete in markets[12] and thus one cannot make a credible argument that we should just assume that efficiency-oriented experts and policy makers have devised the optimal governance arrangements to promote this efficiency.

More institutionally-oriented rational choice analysis can provide some insights that a narrow focus on the efficiency of markets cannot. The remarkable variety in governance relationships could reflect optimal cost-benefit trade-offs between organizational alternatives along four dimensions. On the dimension of scale, there can be a trade-off between economies of scale and the ability of policies to match the diversity of local preferences. On the public-private dimension there can be trade-offs between the degree to which the costs and benefits can be contained within a set of private-sector interactions and managed at low cost by the private-sector actors engaged in those interactions, and the degree to which externalities spill over in a way that calls for public-sector intervention, despite the costs of the public-sector capacity needed to do so. On the dimension of territorial jurisdiction similar arguments can be made about scale and externalities. On the formal-informal dimension there can be a trade-off between the costliness of creating highly specific contracts, treaties, tribunals or other formal arrangements that anticipate future contingencies, and the benefits in terms of stability or credibility that such specificity brings (on these trade-offs see for instance Kölliker, 2006; Abbott and Snidal, 2000).

This type of analysis can explain to some degree the prominent role of informal, private-sector or hybrid public/private, arrangements in the governance of global finance. For instance the shift in power away from the large formal IMF to the smaller informal G7 could be explained as a response to the diseconomies of scale of the larger organization. Similarly the heavy reliance on informal regulatory committees could be explained as a more cost-effective way of dealing with a rapidly changing environment than the more cumbersome alternatives of creating formal

[12] This is the focus of rational choice political economy literatures, including the law and economics literature.

intergovernmental organizations or treaties. Many of the private-sector governance arrangements, such as the CFP Board, could be seen as optimally private given the lack of externalities that spill over the boundaries of the private-sector members' interactions. These shifts towards more efficient governance arrangements could be the result of a competitive process where some institutional forms outperform others and therefore thrive, or as a result of rational anticipation of future costs and benefits by the architects of these arrangements.

Unfortunately a narrow focus on efficiency obscures other elements of functionality that can make important contributions to understanding the character of multi-level governance in this area. The efficiency focus requires the assessment of any particular arrangement to be based on its costs and benefits relative to alternatives, and this makes ad hoc analysis more likely because relevant factors outside the activity of the arrangement, such as system-wide developments or elements of the physical environment, are treated as exogenous and counter-factual alternatives are difficult to assess. Moreover, since costs and benefits cannot be measured one needs to take the success of the institution as evidence of its efficiency, creating circularity: the institution successfully exists because it is efficient and we know it is efficient because it successfully exists.

A broader approach to functionality, such as was set out earlier in this paper, can help address some of the deficiencies of a narrow focus on efficiency. The proliferation of regulatory groupings are all specialized, task-oriented, and relatively autonomous. Where previously, for instance in the 1960s, almost all international public sector financial interactions were carried out by top central bank or finance ministry officials working directly with one another or through the BIS, IMF or World Bank, today there are specialized groupings for the regulation of banking, insurance, securities, and other policy fields. These groupings have been set up in a seemingly ad hoc manner to address particular problems, but then they have become ongoing institutions generating new institutions to address new problems of coordination among them (Porter, 2003). The pattern corresponds to the notion of spill-over identified in the functionalist theorizing of early European integration theorists. The coherence and identify of the groupings is strongly shaped by their highly technical work, which in turn is shaped by the particular constraints of the environment they seek to regulate. For instance the Basel Committee's coherence is organized around its capital adequacy projects, which have in turn been shaped by the potential and limitations of the technical models that are used to manage banking risk.

On the private sector side, similarly, the 225 associations mentioned above are almost all oriented towards specialized functional activities, such as the Wolfsberg Group on money laundering, the International Union for Housing Finance or the International Actuarial Association, rather than seeking to represent financial firms on a variety of issues. Private-sector associational activity in global finance is remarkable for how weak general associations are relative to the power and influence that is often assumed to be associated with internationally active financial firms, with the Institute of International Finance as the exception that illustrates the rule.

Narrower efficiency-oriented approaches might lead one to expect a mix of sizes of governance institutions with different degrees of competition depending on the economies of scale associated with the character of the service the institution "sells". Economies of scale and scope would lead to some governance institutions to move into other governance "markets" and engage in mergers and acquisitions. However this is not at all the picture we see in the governance of global finance. Instead we see a proliferation of ever more unique and specialized governance institutions. In some cases this can be explained on the basis of efficiency

considerations associated with the economics of networks, in which each additional participant greatly increases the value of the network to every other participant. This would be the case, for instance, with the Clearing House Inter-bank Payments System (CHIPS), an association that manages an electronic network for clearing 95% of all US dollar payments between banks world-wide. However our understanding of CHIPS and most of the other public and private governance institutions is better served by a broader approach to functionality in which a particular technical problem elicits collaborative work, held together by shared communicative codes about the problem, that then may be formalized as an association or regulatory grouping rather than by the idea that there is an implicit market for governance services.

Politics

The picture painted in the previous section's discussion of functionality might suggest that existing governance institutions emerge automatically and optimally in response to problems that arise. Such deterministic Pollyannaism has been devastatingly criticized in earlier sociological models of functionalism and correcting this problem by recognizing contingency, agency and politics has been the focus of a subsequent neo-functionalist sociological literature. In this section I similarly consider the political factors that explain multi-level governance in global finance.

One approach that offers some insights but that is also quite limited is state-centric realist international relations theory. In this theory self-interested states are the only relevant international actors and outcomes can be predicted from the distribution of capabilities among them. In global finance the leading role played by the US, working with the UK, (which was hegemonic in an earlier period) has been well documented (Helleiner, 1994, Kapstein 1994). In the IMF and World Bank the US has the explicit right to exercise power commensurate with its large share of world resources, for instance through weighted voting systems, and there is much evidence that the US shapes outcomes informally, structurally (for instance through the influence of its universities in the training and recruitment of IMF staff, see Momani, 2005), or surreptitiously as well. There are many reasons to assume that the vigorous promotion of financial liberalization by the US government is due to the political influence and campaign contributions of large firms from Wall Street rather than functionalist problem solving. From this perspective the growing importance of the IMF or the Financial Services Agreement at the WTO at the international level is due to ability of powerful states, especially the US to shape the world in its own interests. As the EU has enhanced its own capacities, including through the creation of the Euro, it is likely to alter outcomes accordingly. One might interpret the growing role of the International Accounting Standards Board relative to the global use of US standards as an example of this, since despite the common perception of the IASB's standards as Anglo-American it is unlikely that it would be so important without the EU's legal endorsement of its standards and the growing need of EU firms to draw on international capital markets. There are indications of a modest increase in the power of developing countries on the public-sector side of financial governance that could account for some features of multilevel governance such as the emergence of regional bank regulatory groups.

Despite the undeniable preeminence of the US and other examples of realpolitik in certain aspects of global finance there are also many key features of global financial governance that state-centric realism has difficulty explaining. These include especially the role played by functionally-oriented public sector groupings or the rulemaking of private-sector bodies such as

the IASB that retain some important autonomy from the US government (Porter, 2005b). State-centric rational choice approaches such as neoliberal institutionalism that are more developed than traditional realism explain such developments as reversible delegation, perhaps with some slack as predicted by principle-agent theory (Mattli and Büthe 2005). However these theoretical responses can involve non-falsifiable assertions of the importance of states in the last instance that obscure the more relevant question of how it is that these "delegated" governance responsibilities developed in the particular way they did, and why their key governance initiatives tend to be formulated with reference to technical logics rather than through directives from or lines of accountability to top policymakers in their member states.

Moving further away from the state-centrism of traditional realism, it is possible to identify other roles played by politics in multi-level governance in global finance. Private associations are often devoted to enhancing the power of their members, either by securing benefits for them from the public sector or by enhancing their members' market power. With regard to the former, the 2004 provisions from the Basel Committee on Banking Supervision are especially advantageous to very large banks (Claessens et al, 2004) and this could be traced to the ability of those banks to exercise influence through the IIF. With regard to the latter, some international accounting associations such as the International Group of Accounting Firms, Limited (IGAF) or Independent Accountants International (now Polaris International) can be seen as examples of smaller firms banding together to enhance their market power relative to the big four multinational firms that dominate the market. Neo-Gramscian approaches highlight the transnational connections between financial elites and the strengthening of international institutions such as the IMF (Gill, 2003).

There are also ways in which the heavy emphasis of functional arrangements on expertise can be seen to have a political dimension. Experts may arbitrarily elevate their own influence to gain power or, if they are part of a firm, to become wealthier from selling knowledge. Powerful actors with an interest in the status quo can remove policy issues from public scrutiny by delegating them to apolitical experts. The minimalist approach to reforming the international financial architecture in the wake of the financial crises of the 1990s has been attributed to such a desire of powerful states to maintain the status quo (Soederberg, 2002). However the idea that all elements of functionality discussed above are an effect of power is not credible since it is obvious that some functions have a utility that extends beyond the self-interest of those who create them. Moreover functional imperatives can also constrain power. For instance financial firms lobbying to see their preferences implemented in international regulatory groupings need to justify their positions with reference to highly technical arguments and their ability to exchange favours for policies can be severely constrained. This relationship between power and functionality is important and I return to it in the next section.

Overall it is clear that political explanations have a contribution to make in understanding multilevel governance in global finance but that they tell only part of the story and cannot substitute for approaches that emphasize functionality. Both functionality and politics are important parts of the evolution of multi-level governance, and thus an arbitrary emphasis on one to the exclusion of the other is problematic. This then raises the question of the relationship between politics and functionality, which in turn provides an opportunity to consider the relationship to democracy of this relationship.

The Relationship between Politics, Functionality and Democracy

The difficulty of judging the relative importance of functionality and politics is evident whether we see functionality as driven by technical imperatives beyond the control of human agents or as a rational or political choice by such agents. How can we know that the assertion that a technical imperative exists is not a political one? How do we know that the personal benefits that accrue to the architects of a functional association or governance arrangement are so excessive as to be labeled rent-seeking as opposed to reasonable compensation for their effort? This requires an assessment not just of the architect's individual performance and remuneration, but also the social value of the function that they supply. Implicit market competition in the supply of such functions is clearly inadequate to provide a benchmark for such assessments, especially since such competition may completely fail to produce some alternative to the status quo.

When governance is shifted from the state to other levels that are more distant from popular scrutiny, whether these are more supranational, private, or expert, this shift could involve four alternatives:

1. The shifted governance is functional but has relatively little public relevance and thus the loss of accountability to citizens is not significant;
2. The shift brings functional benefits so that citizens accept a loss of accountability because they are perceived to be outweighed by those benefits;
3. The shift is functional in bringing new public policy problems that the state previously could not manage into public policy processes, and in doing so increases public accountability.
4. The shift favours some actors at the expense of others and has no functional benefits sufficient to compensate citizens who are harmed by the effects of the shift, including the loss of accountability.

Assessment of any particular governance arrangement is complicated by the difficulty of discerning the degree to which its work has public policy consequences in addition to the difficulty of discerning whether those consequences are positive or negative. Some governance arrangements are more self-regulatory—they are directed primarily at those who manage them—while others are designed to affect the conduct of other actors. Stock exchange regulation or the Clearinghouse Inter-Bank Payments System are examples of the former while bond rating, the IASB or IMF conditionality are examples of the latter. However many governance arrangements mix elements of both. For instance the Basel Committee members impose a commitment to regulatory standards on themselves with the intention of better regulating external actors—banks—but in doing so are ultimately aiming to protect citizens from the consequence of bank failure. Moreover an arrangement that is ostensibly purely self-regulatory can create a capacity to carry out an activity that in combination with other such activities can have larger public policy consequences. Thus the technical public and private arrangements in global finance that at first glance have relatively little public policy relevance might be viewed by critics as complicit in the negative consequences of financial globalization because they facilitate this globalization.

Despite these difficulties three conclusions about the multilevel governance of global finance can be drawn:

1. Global finance is populated and enabled by a wide variety of public and private governance arrangements with organizational capacity that is essential to its functioning, and thus the image of finance as involving a struggle between states and atomized, anonymous quasi-natural financial market forces should be discarded.
2. This complex multi-level governance gives states new potential to address public policy problems and citizens new choices, whether this is finding new sources of capital or controlling financial instability.[13]
3. This potential is very vulnerable to being countered by powerful self-interested actors that are not held in check or are empowered further due to the diminished accountability that comes with multi-level governance, although some aspects of multi-level governance, including its focus on functionality, can also constrain these actors, who may have to alter their conduct in accordance with functional imperatives and discourses and who may find the increased complexity harder to manage (Grossman, 2004).

This then leads to a fourth and final conclusion, which is the need to democratize meta-governance. Erasing multi-level governance in finance is neither possible nor desirable. Even critics of global finance should agree that some type of governance beyond the state is desirable, and there are indications that civil society critics have increasingly begun to engage with how such governance might be improved or strengthened, for instance through a Tobin tax, rather than simply being abolished (Porter, 2005a: Chapter 9). However political mechanisms for deciding on the optimal distribution of policy processes across multiple levels of governance have lagged seriously behind the strengthening of those multiple levels.

Why might there be hope that such mechanisms could be developed? It might seem that powerful actors that self-interestedly benefit from multi-level governance might have the capacity and motivation to prevent them. One response is that less powerful actors, including non-financial civil society actors or weaker financial actors, will enhance their own ability to offset these powerful actors, and they could be aided in this by the constraints imposed by functionality issues on the arbitrary exercise of power. As noted, such constraints can include the need to justify policies with reference to technical models rather than by promising campaign contributions, and these technical models can include public interest parameters. At a more macro-level, even powerful actors need stability, and in a complex disaggregated system this requires the consent of less powerful actors. In financial governance we can see this in the moves of groupings of wealthy countries to bring less developed countries more into policy processes, as has occurred when the G7 created the G20 or the Basel Committee has fostered relations with regional committees of bank regulators in the developing world.

An example of this dynamic is provided by the EU's Financial Services Action Plan, which in addition to being an initiative to integrate European financial markets also was very deliberately reflexive about the multi-level governance process to manage this. The FSAP's "Lamfalussy process" included four levels ranging from the setting of general guidelines to specific implementation. The European Commission's 2007 report *FSAP Evaluation* noted that it "aims to draw conclusions that will contribute to the preparation and design of future policy interventions and improve their quality and assist in designating appropriate resources for future actions" (European Commission, 2007: 3-4). The report noted that "When the FSAP was being

[13] For an argument that informal networks enhance regulatory capacity while also creating legitimacy issues see Eberlein and Grande 2005. For a more skeptical view see Schout and Jordan, 2005. Caduff and Bernauer (2006) argue that centralization is better than multilevel governance for food safety.

drawn up, heavy emphasis was placed on the fact that consultation would be undertaken as widely as possible" including with "representatives of market practitioners, consumers, users and employees" (pp. 11-12). The report then notes that

> At the outset of the FSAP, the practice of wide public consultation was not yet standard practice in the elaboration of legislative proposals. Consultation was limited to the sounding out of specific, hand-picked industry representatives and also Member State experts through the various contact committees… industry participants and the public at large were not formally consulted on the proposal and the Commission made a serious error in not doing so.

This led to objections to the content of the initial FSAP proposals, and a legislative "fracas", and the European Parliamentary Financial Services Forum concluded that its intervention had been necessary to correct technical problems arising from this lack of consultation (p. 13). As a result consultation was enhanced in the rest of the FSAP process, and this is now seen by the Commission as a *"sina qua non"* which is built into its White Paper on Financial Services Policy 2005-2010 which was issued in 2005 (p. 15). The report notes that it is difficult to obtain input from "users and customers" on financial policy issues and the White Paper consequently calls for "the constitution of a permanent group of consumer representatives from across Europe, a periodic newsletter on financial services issues of interest to consumers and the organisation of a conference on increasing consumer financial capability" (p. 16).

This experience points to a way in which the tension between functionality and politics can be resolved by democracy as policy processes are redistributed across multiple levels of governance and become more complex, just as happened earlier with the development of nation-states. Both the politics and functionality of democracy can work to resolve this tension. This is a lesson with implications not just for financial services in the EU, but for global finance and global governance more generally.

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