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World market governance

Why the global market economy urgently needs effective, transparent and comprehensive governance and why it should be developed separately from the national public orders

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The market economy has so far proved to be the best system to create wealth ever imagined, but it needs just like a good game of soccer fair and transparent rules and a judge to see that the rules are followed. It does not need committees sitting on the sideline directing the players what to do. The players can and should be trained, but when they are out there on the green field they are on their own. They have to take the decisions on how to play – offensively or defensively, cooperatively or individually, traditionally or innovatively. But without the rules and a competent judge the games would be ugly and the outcome would not be generally accepted. The same is true for the market economy and as long as the "market matches" were mainly national and the rules decided by the nation states the system was reasonably under control. But now that the market economy has moved from a national to a global arena there is a lack both of proper rules and proper surveillance. The problem is serious as the global scale has made the economy not only more dynamic, but also more vulnerable.

Researchers have increasingly started to reflect upon this new situation. I have been given the opportunity by the European Commission to develop a research project on World Market Governance that I started at London School of Economics and now am continuing at Potsdam University. The European Commission has not endorsed my findings and proposals, but the support from the European Commission has allowed me access to leading officials in key countries, G20, WTO, OECD, think tanks and the like. The discussions have been valuable and there is a willingness almost everywhere to look into new ideas and approaches. At the same time politicians and officials feel hindered in their actions by established ways of thinking and obsolete theories.

In my work I sometimes have felt like the boy in The Emperor's New Clothes, the famous tale by HC Andersen. "The Emperor is naked" the boy said. "Fool!" his father reprimanded, running after him. "Don't talk nonsense!" The boy spoke loudly about what everyone else knew, but did not dare to admit. They had been told that if they did not see the emperor's new clothes it was because they were stupid and incompetent.

I am challenging common perceptions and some of the works of the most respected philosophers and thinkers of the last two hundred years. This is something you do not do lightly, and I have initially been met with a certain resistance, a resistance that has softened over time as more and more interlocutors have become sympathetic to my resolve to talk loudly about the Naked Emperor.

Who is he? He is above all the Rational Man – the most revered myth of the twentieth century. My claim, based on contemporary research about human nature, is that Man can reason rationally, involve himself in public reasoning, but that he does not do it all the time, and, above all, that he may not act in accordance with his own rational reasoning. If that was the whole argument, I need not to have met many objections. Few would have run after me screaming "Don't talk nonsense!" That the Rational Man is a too simple understanding of man is recognized by most scientists today, even if many yet have to draw the conclusions of this knowledge.

I also challenge the role of the Emperor and this is a much graver and daring claim. He may believe that he is the sole Master of his country, but he has to start realizing that the market economy that he once could direct within his territory has started to evolve into a global societal system that is increasingly outside his control. He and other rulers of nation-states are facing two challenges.

First. How are they to control the global market economy that has emerged as a societal system in its own right; that is central to the life, health and property of people; that can induce harm, from which there is no opt-out and that has a global reach that out-matches the public order? The present mainly inter-governmental governance has two weaknesses. It demands unanimity and it requires equal implementation. The effect is a regulation that is insufficient, patchy, mainly reactive and unevenly implemented, environmental challenges that are left unaddressed and a global economy that is likely to move from crisis to crisis.

Second. How are they to regain the sovereignty to decide upon social conditions in their own countries when the insufficient governance of the global market economy enables financial actors, global companies and wealthy citizens to benefit from regulatory arbitrage, i.e. use the fact that countries have different factual regulations in order to locate and administrate their businesses and lives in a way that minimizes taxes and control? The gap between the 'have' and the 'have-nots' is steadily increasing. The situation is not simplified by the fact that many Western countries already find themselves in difficulties due to careless borrowing in the good old days and the socializing of bank and household debts during the 2008 financial crisis.

The way out of this dilemma is to see the world as it is and not try to cover the Naked Emperor with the flimsy shield of sightlessness. Man is not consistent in his values and his expectations; the mainly "bottom-up" market economy is responding to partly other features of human nature than the "top-down" public order. The two liberal projects even have different philosophical backgrounds, although the conclusion that they should be seen as separate societal systems not has been drawn yet. Amartya Sen e.g. makes a difference between the arrangement-focused "transcendental institutionalists", such as Thomas Hobbes, John Locke, Immanuel Kant, Jean-Jacques

Rousseau, John Rawls and Robert Nozick that have inspired the democratic project and the realization-focused "comparison" as advocated in different forms by philosophers such as Adam Smith and the Marquis de Condorcet and that has inspired the market economy project (Sen, 2010, p. 7).

There is a lot of evidence of the need for an urgent rethink available for those who want to see the obvious. The Emperors of this world do not necessarily need new tailors, but the tailors need new materials and new equipment so that they can dress the Emperors properly. We are in the midst of a new evolutionary phase and we need to find global institutional arrangements that can meet the challenges that an emerging global market economy offers. Such global governance is also a prerequisite for the nation-states to regain the sovereignty to decide upon the social and cultural conditions in each country.

1. The market economy – A winning concept

There was no shared view on how a national economy should be run among the nation-states that emerged after the Second World War. The relatively free market economy in the US stood in sharp contrast to the planned economies of the socialist countries. In between those extremes you found different versions, the developing European welfare states, a corporate Japanese economy and socialist market economy experiments in countries such as Yugoslavia. It is fair to say that at the time in which most of the present global institutions for the governance of the global economy were created there were several competing types of economies of which some deserved the label market economy, some not. Somewhat surprisingly I have, when discussing early drafts with scholars in different think-tanks and institutions, discovered that many still perceive the world this way. Some continue to see a fight between different economic models, models that are competing with one another; they perceive the financial markets as the final arbitrators, the ones to decide which countries and models that are to win and which that are to fail.

My perception is a different one. The situation after the Second World War has to my mind changed dramatically and today we can hail a winning economic model. When the populations raised their opposition to the authoritarian communist regimes in the old Soviet Union and its satellites they did it only partly because they wanted more freedom. The main reason was that the planned socialist economies and the so called socialist market economies failed to deliver the development and general welfare people were demanding. Surveys show that we on a global scale have learned the lessons from the planned economy experiments. More and more people around the world are now embracing the market economy concept as the best system created to meet our steadily evolving desires and our wish to be recognized.[1]

[1] Even if surveys show a sharply decline for the support for the market economy concept in countries like Latvia that have been forced to take drastic actions in response to the sovereign debt crisis.

There is no perfect market economy. Almost all economies have some deficiencies, often because, as already Adam Smith pointed out, it is in the interest of the actors to try to abuse the system. Companies, but not customers, like monopolies. Traders, but not the ordinary investor, like inside information. When entrepreneurs use their contacts to get deals that they cannot get on the market, their competitors suffer unfairly. Most economies in corrupt autocracies that do not care about the needs of the citizens perform badly. It is to a high degree the strength of the public order that decides how well a market economy functions. The Chinese economy is perhaps today the foremost example of a market economy with an outstanding growth, but also with an inability to address external problems such as negative environmental effects created by the growth. The reason is a far-reaching decentralization of decisions that concerns the market and a growing interdependence between localities and the fast-growing companies.[2] Bo Rothstein (see e.g. Lindvall & Rothstein, 2010) has in his research shown that countries with strong social institutions that create a climate of trust have better functioning market economies. The level of trust has for example a great impact on the level of corruption. There are lessons to be learned from this research in the governance of the market economy, but the fact that some market economies perform better than others due to the domestic environment does not make the models as such different. It just makes their relationship to the public order different.

The market economy as a winning concept has been enhanced by several factors.

- The fall of the Berlin Wall had an enormous psychological impact. Some philosophers such as Francis Fukuyama even proclaimed "The End of History", which to philosophers mean that there is no place for further development of the foundations for political philosophy, including the running of the economies Fukuyama (1999). The liberal project, of which the market economy is a centrepiece, had in the view of Fukuyama won a decisive victory, even if he in the last chapter of his famous book expressed less final opinions.
- The WTO is demanding that countries who want to become members are recognized market economies i.e. receive Market Economy Status (MES). Countries have to implement best practice standards to live up to the WTO requirements (even if the perfect market economy still is wanting).
- The OECD and the IMF have developed bench-marking, in which the performance of different countries has been publicly compared and the OECD has developed different codes of conduct that have influenced corporate governance.
- The information technology revolution has created companies with global supply-chains and global markets. Those companies are pressing countries to synchronize regulations and conditions.
- The European project has harmonized the conditions within the EU and forced accession countries to rapidly adapt best practice.

[2] The central role of The Communist Party is described by Richard Mc Gregor (2010).

My conclusion is that we have moved a long way from the disparate models for the functioning of the economies in which we found ourselves after the Second World War to the harmonized "best-practice" market economy concept that has been increasingly winning the day.

2. An emerging global and integrated market economy

The emergence of a winning market economy model has been one of the factors driving the development of a global integrated economy.

Another factor is the failure of protectionism. During the Great Depression of the 1930s, countries attempted to shore up their failing economies by sharply raising barriers to foreign trade, devaluing their currencies to compete against each other for export markets, and curtailing their citizens' freedom to hold foreign exchange. These attempts proved to be self-defeating. World trade declined sharply and employment and living standards plummeted in many countries (see www.imf.org). But it took time to learn the lessons. The trade between countries remained limited in the immediate aftermath of the Second World War. Only some five percent of the US GDP was related to trade. Many countries in Europe were preoccupied with the rebuilding of their industries and had an internal focus. Regulations that hindered the free flow of capital between countries remained and were common. The banks were strictly regulated.

The internal and protectionist focus has successively given way to a more open attitude in which financial markets have been deregulated and trade between countries step by step has been liberalized. The opening up of the economies, especially of trade, has been perceived as a success as it has coincided with a rapid growth in living standard in those Western economies that most actively have participated in the globalization process. The Single Market initiative in Europe proved to be an achievement as it increased business opportunities and growth. The economies in countries that remained closed, especially those behind the "Iron Curtain", on the other hand faltered.

The drivers behind the spreading of industrialization are well-known. The Western economies have moved from being agricultural and industrial to become knowledge and service oriented. More than half of the world's population is, however, still in farming. There is a well-described global dynamism in which countries on the early stages of the development curve are trying to catch up with the countries higher up. So far this dynamism has been proven to be a win-win situation for everyone, but there are now many in Europe and the US who are starting to question if the world economy has not passed the point where all are winning and have come to a stage where the US and Europe are starting to be on the losing side.

A reason why it could be different this time is the sheer scale of the emerging countries' potential. The populations of China and India outnumber Europe and the US together more than three to one. When they catch up as Japan did and South Korea is close to doing their economies will be far bigger than the US and European economies together. That would have an unprecedented impact on the global market economy as it would change the epicentre of global power.

Another reason why it may be different this time is that information technology has enabled an outsourcing of production in a scale hitherto unseen. Factories are being closed down in the Western economies at a worrying and seemingly accelerating speed. What is happening is that information technology enables companies to put together supply and production chains that can ensure quality and just-in-time delivery that were not achievable before. A designer of clothes in Milan can program a CD-ROM that in a detailed way describes how a machine in Bangladesh can produce a dress he has created. And as the telecom systems are expanded he can send the instructions on line. Shops can within the system that the designer has created individualize the dress to fit special individual needs and send an order of the fitted dress directly to the machine. Logistic companies ensure that the dress is delivered just-in-time and they have track and trace systems that enables the shop to observe where in the delivery chain the dress is at a given moment of time. The reliable production and delivery system enables shops to keep a minimum of dresses in store and the supplier to produce new dresses in line with actual demand.

If you want to buy a new car it will no longer be produced until you have made an order. It is possible for you to ask for special features and it will seldom prolong the process. The assembling of the car represents perhaps only ten percent of the value of the car. Almost all the parts of the car are produced somewhere else than in the assembly factory. Germany is the leading producer of auto-parts, but the parts may come from anywhere, from factories in Italy, Sweden, China, Japan or any other place that has proved to be competitive. The distribution of work on a global scale enables factories to develop economies of scale and scope that makes them more or less independent of the local cost level. Automation and robots steered by IT-systems also help to drive down the costs.

Companies are increasingly globalized. They can grow organically, but are often the result of mergers in which synergies in the form of for example joint supply-chains are exploited.

“Glocal” has become a buzzword. Companies are global at the same time as they try to market their products and services with a local flavour, adapting to different cultures and customs. The IT-systems enable the companies to make those local variations without losing economies of scale.

There is nothing in this development that in principle has to make anyone a looser or assures anyone to be the automatic winner. When industrialization came to Europe each country started to develop its niches, trying to establish comparative advantages. The Germans developed chemical industries and manufacturing for industries. Swedes became experts on anything built on its natural resources – steel and wood. The French developed energy and food companies. The Italians designed shoes and clothes etc. The new global landscape is challenging many of those niches, and it will be tougher to defend them and to build new ones, but the fact that the competition is global does not in principle change the way it works. There is always a place for the innovator and first mover, the entrepreneur who sees an opportunity and starts building a business before others are capturing the market. It is up to the nation-states to use this space for creativity and for support to innovation.

The globalization is, if anything, increasing in strength and speed. The global trade has for a long time been growing much faster than the global GDP. In other words, we are on a global scale consuming relatively more of imported products and exporting more of our own production. The dip in global trade following the latest financial crisis is already overcome, mainly thanks to the emerging economies. China was in 2010 increasing its export by 37 percent and its imports by 51 percent (according to China Daily, February 2011). Of the export 55 % were produced by companies with foreign owners. China has become the first or second trading partner to most developed countries and the buyer of 30 to 50 percent of the worldwide output of minerals and other commodities.

The official Chinese position is that it is a developing country that needs to concentrate on the domestic development, and it is true that China has many facets. While more skyscrapers are built in cities such as Beijing and Shanghai than in any other part of the world, while the economy is steadily growing by ten percent a year and China has overtaken Japan as the second largest economy in the world, it is still a country in which a hundred million are living on under two dollars per day and in which most people are in want of health care and pensions. The Chinese government has made it a top priority to address these inequalities in order to keep the support of the rural population for the direction of the country. One of the actions taken is to encourage companies who are feeling the strain of increased wages in the coastal areas to move their production to lesser developed areas inland.

China may for some decades keep a competitive edge through the policy of moving production internally, and the official view is that the whole vast country will not be developed until 2090. The Chinese position is thus that it will take quite a while until they have to worry about the loss of competitiveness on the global market and that they therefore can take a passive attitude to the development of the global economy. This perception is perhaps not as well-founded as the official view may suggest. The global imbalances can, if they are not addressed, create recurring financial crisis. All emerging economies are also sooner or later facing a situation when it becomes more and more difficult to match an increased domestic cost level with productivity gains. History has some lessons to teach.

Production in wage-sensitive industries such as textiles is already moving from China to other emerging economies such as Vietnam and Bangladesh. Commodity-rich African and South-American countries are also showing growth potentials. China is usually the first to highlight that the country is not the only emerging country and that the perception that the US will be replaced by China as the new dominant world power is faulty. The decline of US power due to the loss of competitiveness is obvious, even if a majority of the Americans are in denial, but it is not self-evident that China will be able to take over the US role uncontested. The demographics are against such a development. In five years time the population between 15 and 64 years will start to decline and the foundations for a continued exceptional Chinese growth less obvious. India, Brazil and Russia are for example three other countries with a large growth potential and with a joint population twice the size of China, and other countries are aspiring to take over when those economies reach the phase in which they start to become vulnerable.

3. Integrated financial markets

The deregulation of the financial markets that has taken place step by step after the Second World War accelerated in the late eighties and early nineties and is one of the factors that have contributed to the development of a truly global market economy. The order of events can also be seen in the opposite light, namely that it is the global business opportunities that have been driving the deregulations; global companies need global financial partners. The imbalances between savings and investments on a country basis have also been driving the opening of markets worldwide; the financial actors, who have a responsibility to invest the assets entrusted them, need the access to global markets in which they can find a reasonable return. The volumes of money put at risk at any point of time in the global economy are impossible to envisage. Calculations hint at figures in the ballpark of hundreds of trillions of dollar. Of special importance for the global stability are the currency reserves. They were in 2004 about three trillion dollars of which less than one trillion dollars were to be found in the Chinese reserves. In 2010 the global currency reserves have reached nine trillion dollars of which three trillion dollars are in China. The development reflects gaps in current accounts. Before the crisis the fuel exporters, Japan, China and the EU countries (as a group) had strongly positive current accounts, while the US, India and other emerging and developing countries had negative current accounts (Martin Wolf, Financial Times, 6 April 2011). The growing imbalances, temporarily halted by the crisis, contribute to the need for a global financial market.

The development is not without risks. The knowledge of foreign markets in which actors enter and the new creative products they are offered is not always as deep as one would have desired. The technology is pushing the decision-time to a minimum, yes, even to the point in which machines take over the trading. The risks for faulty decisions based on perceptions and group conformity have increased. The existing regulations and information avenues have proven to be inadequate.

Many blame the Washington consensus, the economic school that has dominated the IMF, the World Bank and the US Treasury, for the seemingly inadequate regulation of the financial markets. The Consensus for a long time remained faithful to the Rational Choice Theory and the General Equilibrium Theory, which we now know to give an incomplete picture of the financial markets and the economy as a whole. There are psychological reasons, such as group conformity and collective self-justification, why the consensus economists abode by their models, but that is already history. Leading proponents such as Alan Greenspan have concluded that their belief in the self-correcting and self-regulatory power of the market has been mistaken. Economists in central banks and finance ministries around the world are now looking for economic models that give a better representation of the markets.

4. The need for governance

We are seeing the emergence of a global market economy supported by global financial markets. That the latter needs a coherent and effective regulation is increasingly apparent, but it is not only the financial markets that need more coherent global governance – so do other aspects of the global market economy.

The market economy is a bottom-up system and, as such, it mainly needs predictable and transparent rules, not intervening institutions. But it does need the rules; a level playing field is a precondition for effective markets. As long as the market economies were mainly national the nation-states could offer such rules and also ensure that they were followed, but the possibilities for the nation-states to offer such stable environments are getting weaker as the globalization process proceeds. The development of the global market economy is demanding a similar set of rules that mostly exist on national[3] level, the difference now being that they have to be applied globally. Global companies that are active in many countries as well as other exporters and importers need a level playing field for the markets to work efficiently. A lack of governance shows up in recurrent financial crisis, but also in transaction costs. Companies have to tackle not only transportation costs, but also costs for uncertainty in rules, in the stability of the financial markets, in the enforcement of contracts, patents and the like. The lack of governance also shows up in diminished sovereignty of nation-states, especially if they are dependent on the global financial markets in order to finance public deficits. The nations-states find themselves in an unpredictable global environment on which they have little influence.

Besides a proper regulation of the financial markets the following elements are central to a functioning global market economy (the list is not intended to be exhaustive, more to be illustrative)

- Agreed rules for acquisition and sales of assets
- A common foundation for the exploration of natural resources
- Harmonized competition rules
- Recognition of Intellectual Property Rights
- Basic labour and migration conditions

[3] In the case of EU partly on European level.

- Agreed ways of internalizing “externalities”, such as environmental impacts, into the market economy system.

Does such governance exist? The answer is that it does to a certain extent, but that the governance is insufficient and that the short-comings will be more and more obvious as the globalization process continues. The globalization is in itself also demanding a regulatory framework that nation-states don’t need. Three examples are regulations that support

- Free and fair trade
- Stable currency relations
- Fair domiciliation of companies and citizens for taxation.

The latter is important to avoid some of the regulatory arbitrage.

There is a clear need for developed governance of the global market economy. To quote a leading sceptic to the globalization process, Rodrik: “Unlike markets, which tend to be supported by domestic regulatory and political institutions, global markets are only “weakly embedded.” There is no global regulator, no global safety net, and, of course, no global democracy. In other words, global markets suffer from weak governance, and are therefore prone to instability, inefficiency, and weak popular legitimacy” (Rodrik, 2011, p. xvi).

5. An increased vulnerability

It is a fact of life that the Western economies as a whole are more vulnerable after the latest crisis and will have fewer resources to meet new crisis. At the same time they are just like China and other emerging economies becoming more and more dependent of the development of the global economy as the tendency is that trade is playing a larger role year by year also in their economies. There are no longer any “islands” in the global economy. The future of every single market is dependent on the development of the global economy as such.

Many see a parallel to the end of the first modern globalization period hundred years ago. It had other characteristics, driven by colonialism and exploitation by military means of weaker countries, but it ended in a way that makes some economic historians nervous. The governments were at its end unable to control the forces of the financial markets; their responses in the form of protectionism and other measures may even have deepened the crisis that did not end until the world had experienced both a Great Recession and a Second World War.

The parallels should not be drawn too far, but what is worrying is that many, including the researchers that met at the invitation of the International Monetary Fund (IMF) in March 2011, have concluded that the rescues of the banks and the financial institutions have “only treated the symptoms of the global financial meltdown” (quoted from Floyd Norris, iht 11 March 2011). The Western economies are ill-prepared for a new financial crisis and many believe that the world is about to miss a chance to make it less likely.

Some already see the early signs of a new financial crisis, some are worrying about a Japanese development in the Western hemisphere, others about the increases in money supply, oil and food prices that can lead to expectations of inflation, leading to inflation, demanding monetary policy responses, creating stagflation or even a recession.

The challenges facing the world are serious, but there are glimpses of light. The whole world economy is not in a dire state. The initial financial crisis has after all been fought off, even if the heavy sovereign debts will remain with many Western countries for a long period of time. The European project has brought peace and stability to a continent that has been war-ridden for centuries, and the European politicians have shown a remarkable ability to muddle through crisis after crisis, even if they not until lately have started to understand that they cannot count upon the global financial markets as a reliable partner in their efforts. The benefits of industrialization that earlier were experienced mainly by the Western societies are spreading fast among populations in especially Asian countries. There is a strong belief in the future among citizens in countries such as China and India. The death rate among newborns has declined sharply in the developing countries; more children are given education and the transmission of many deadly diseases has been halted. Fewer are living in life-threatening poverty than when the ambitious Millennium goals were agreed.

But it is a shaky progress. Regional and local conflicts and struggles for control over natural resources in many African and Arab countries affect the whole world. Not only the financial imbalances, but also the environmental challenges, have to a large degree been left unsolved. And while more people reap the economic benefits of progress, the gaps between the have and the have-nots have increased both within nations and between nations. People and nature in many developing countries are suffering from the effects of a destructive un-restricted capitalism (see e.g. Stiglitz, 2006).

The 2008 financial crisis, which started as a debt crisis with banks and households finding themselves with more debt than assets, has developed into somewhat of a debt crisis for states. Several developed countries, including more advanced economies such as the US and the UK as well as more traditional economies such as Greece and Hungary had undisciplined budget regimes already before the financial crisis. The problems have deepened as many countries have been forced to ‘socialize’ the bank debts in order to keep the banks solvent, and to take over some of the household debts for social cohesion reasons. Already debt-ridden countries have moved the total debt from one place in their economies to another. The Euro zone has been forced to fight distrust towards some of its members by issuing guarantees and loans, by supporting bond-issues, and by establishing a new level of cooperation and discipline. The populations in more financially prudent countries have been asked to help out countries in which irresponsible rulers have granted the citizens social conditions mainly in the form of retirements at early ages that the countries no longer can afford.

The US as well as all of the European countries have quite urgently to learn how to live within their means, to reduce their energy consumption and make better use of available resources for e.g. health care. China and Japan have to find ways of stimulating domestic demand and reduce their dependencies on exports. Nothing would probably contribute more to a better world balance between savings and investments than if China urgently implemented the pension and healthcare reforms that are under way. That would lower the need for private savings, increase domestic demands for products and services and consequently increase investments in China. China would also be able to appreciate its currency more substantially, which would have healthy effects on the savings balance and on the investment level in the West. If India followed suit the positive effect on the world economy would be strengthened.

The globalization is, however, setting limits to what most individual governments can do, limits that create unrest among citizens. Those that are living old battles are often misreading the concerns of people. They see a fight between a free market economy and "socialist" ideas that are already defeated. They do not recognize that it is the lack of a generally acceptable outcome that the mainly unregulated global economy offers that is the issue. Taxpayers have been forced to accept the socialization of bank debts and contribute to stabilizing the debts of other countries. They feel that they have to suffer for something they have no part in. The price for the mismanagement by "the elite" has been forced upon ordinary people to pay in the form of austerity measures and unemployment; it is starting to weigh down on the trust between the rulers and the ruled and has created a fertile ground for parties with extreme agendas. Leaders in the developed countries have difficulties to respond to those sentiments and deliver the growth and jobs that their constituencies are demanding, simply because they do not have access to the necessary tools. The markets are forcing the politicians to try to reduce their deficits through measures, which as a first effect increase unemployment even further and diminish the already waning public support. The leaders are held responsible by their people, but they are dependent on a global economy on which they have little influence. There is as a result a declining support among people in general both for the public order and for the markets. In that respect the state of affairs reminds of the European situation in the thirties', when democratically elected governments fell and were replaced by fascist alternatives (see e.g. Drucker, 1939, reprinted 2009). The situation in developing countries is not all that different. It is not a coincidence that the uprising in many Arab countries has happened now. Their economies have been hit by the global financial crisis and by food prices sky-rocketing due to a combination of low harvests and an unfair global trade regime. It is not obvious to what extent the new leaders will be able to meet the expectations. They have just like their counterparts in the more developed countries little influence on the surrounding economic environment.

6. Insufficient governance

The present governance of the global market is based on two pillars. One is the exercise of military power; the other is a mainly inter-governmental order.

It can be perceived as a bit controversial to recognize that military power has an important role in the steering of the global market economy, but it is a historic fact. The latest globalization period that ended a hundred years ago was driven mainly through military conquest, colonialism and the exercise of imperial powers. The role of military power did not end with the conclusion of that period. It still plays a role, especially in the access to commodities and the exploitation of natural resources. Many bilateral trade agreements in which military strong powers get preferential treatment are connected to security arrangements and arm sales. The US has a position in international affairs that is stronger than its role in the global market economy and it is motivated mainly by its superior military strength.

The role of military power was recognized in the old Westphalia international order, and the role survived to a certain extent in the inter-governmental order created after World War II. The US was given a leading role in that order, a role that for many decades has remained unchallenged although the relative importance of the US economy has declined.

The issue now is that the two complimentary orders are insufficient in order to steer the increasingly complex global market economy system.

In 1944 representatives of 45 countries met in the town of Bretton Woods, New Hampshire, in the north-eastern United States in order to restore a globally open economy after the failure of the protectionism of the thirties that had deepened the Great Depression. The brilliant economist John Maynard Keynes, representing the interests of the UK, and the likewise knowledgeable economist Harry Dexter White, representing the interests of the US, had a central role in the negotiations that took place in a difficult environment; the interests of the US and the UK differed, not all countries wanted to open up their economies and many gave priority to solving domestic issues. The socialist countries had in principle closed their borders and were mostly outside the scope of the negotiations.

The outcome was, given the preconditions a stunning success. Two international bodies were created – the IMF and the World Bank. A third body the International Trade Organization (ITO) that besides trade should stabilize commodity prices, enforce international antitrust and fair labour standards was rejected by the US Congress. What remained of the ITO was a General Agreement on Tariffs and Trade (GATT). A small secretariat was set up and became the embryo to a factual third organization.

The countries that joined *the IMF* agreed to keep their exchange rates pegged at rates that could be adjusted only to correct a "fundamental disequilibrium" in the balance of payments, and only with the IMF's agreement. This par value system – also known as the Bretton Woods system – prevailed until 1971, when the system of fixed exchange rates collapsed. The oil shocks in the seventies led to an international debt crisis that IMF had to address. The IMF has later played a central role in helping the countries of the former Soviet bloc transition from central planning to market-driven economies.

The IMF had a less visible role during the late nineties and the early part of the new century. But as the finance crisis turned into a sovereign debt crisis the IMF got a new prominent role. The IMF has together with EU stepped in to help finance debt-laden Euro zone countries. The end of that engagement is not known or foreseeable when this is written, and new challenges are around the corner. As the IMF points out on its website: “The implications of the continued rise of capital flows for economic policy and the stability of the international financial system are still not entirely clear. The current credit crisis and the food and oil price shock are clear signs that new challenges for the IMF are waiting just around the corner” (www.imf.org).

The decisions in the IMF are formally based on a voting system in which countries have a vote in relation to their economic power. The decision rules have given the US a practical veto. This voting system has just recently been changed and China has been given increased representation. In reality the decisions are dependent on the resources that the fund can attract from the members in a given situation.

The GATT was an immediate success and was able to rapidly reduce tariffs, especially on industrial goods. The present *World Trade Organization (WTO)* was created on the basis of the GATT in 1995 as a result of the Uruguay Round of trade negotiations. Membership of the WTO is not automatic; countries have to have a recognized market economy to join. The WTO is a rules-based organization where all members have the same formal say. The decision-structure is thus different from the IMF and reflects the situation in the UN General Assembly in which all countries have one vote each. The negotiations are however in reality reflecting the relative economic power of the signatories.

The WTO is an organization with teeth. The member countries are held accountable; if the trade agreements that have been signed in the WTO are breached, the trading partners, which have been damaged, can be given the right to retaliate, after an open legal process in which all parties are heard. The WTO is thus an organization with authority that matches its global reach, which makes the WTO different from most other international organizations. In international relations countries can all too often sign up to far-reaching undertakings without being held responsible for keeping their promises. Declarations signed by the participants at UN conferences or meetings like G8 seem sometimes to have been forgotten the moment the signatories have returned home.

However, a worrying fact is that the WTO has encountered increasing difficulties to conclude the negotiation rounds. The latest round, the Doha round, has been delayed several times, although the major countries repeatedly have agreed to make new efforts. The wish to lower the trade barriers to the export of agricultural products from the developing countries is perhaps the most controversial remaining issue. There is a political pressure in Europe and the US to protect the farmers from competition. Northern Europeans have difficulties to understand this pressure given the very high price they have to pay for this policy every time they go to the supermarket. There is also certain distrust between the participants that contributes to the lack of progress in the Doha Round. It is not necessarily a question of clash between personalities; the problem is of a more formal nature. China among others has quite openly questioned the mandate of the US President, given the situation in the US Congress and recent experiences. There is some progress made in international trade relations, but they are mainly achieved bilaterally or between trading blocks.

Not everything the WTO does is uncontroversial. Stiglitz (2007, p. 119–132) criticizes e.g. how the intellectual property regime – Trade-Related Aspects of Intellectual Property Rights, so called TRIPs – have been used to create unfair conditions for the developing countries.

The view that the inter-governmental order is insufficient is hardly unique. The latest financial crisis has added a layer to the global governance in one important way. A so called *Group of 20* consisting of the largest economies and the largest emerging economies was created on the initiative of the French President Nicolas Sarkozy and the British former Prime Minister Gordon Brown. The G20 was a response to the perceived need of a more powerful and decisive structure – and for a while it managed to channel and initiate common approaches. The G20 has met several times in order to coordinate the national responses to the crisis and to strengthen global cooperation in managing the financial markets. The G20 was instrumental in preventing the financial crisis to develop into a severe recession and has taken important initiatives to address pressing issues.

The G20 set out an impressive agenda from the start. A comprehensive action plan was agreed at the Washington meeting in November 2008 (published on www.whitehouse.gov, retrieved the day after), outlining deepened cooperation between the twenty countries. The countries agreed that this work, mostly organized by a new body dominated by central bankers – the Financial Stability Board – should be supervised by their finance ministers. Besides short term actions to increase liquidity and stimulate growth G20 agreed on more cross border cooperation between regulators to supervise internationally active actors, to prevent tax evasion and market manipulations. A review of the scope of financial regulation should be undertaken, with a special emphasis on institutions, instruments, and markets that are currently unregulated, along with ensuring that all systemically-important institutions such as the rating institutes are appropriately regulated. Global accounting standards should be aligned; particularly the evaluation of complex securities. The G20 also called upon more transparency of off-sheet balances and of credit derivatives markets to reduce their systemic risks. G20 members committed to undertake a Financial Sector Assessment Program (FSAP) report and support the transparent assessment of national regulatory systems. A review of the differentiated nature of regulation in the banking, securities, and insurance sectors was to be undertaken. National and regional authorities should review resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border financial institutions. Strengthened capital requirements for banks structured credit and securitization activities were proposed. Risk management was to be improved. The role of the IMF and the Financial Stability Forum (FSF) were expanded but not their authority. The FSF was expected to increase the membership of emerging economies and a redistribution of votes in the IMF should take place. The IMF with its focus on surveillance, and the expanded FSF, with its focus on standard setting, were expected to strengthen their partnership and be more active in giving recommendations related to regulatory issues and standards. The IMF was to conduct vigorous and even-handed surveillance reviews of all countries.

The work on new financial regulations has, since this comprehensive start, been remarkable and the recommendations reached by the new Financial Services Board often far-reaching. Substantial financial commitments have also been made to the IMF (and the World Bank), something the leaders probably have been happy to have done as the sovereign debt crisis in the euro zone has been evolving. The G20 has also sought to ensure that the nation-states do not have to socialize the debts of banks and households if and when a new financial crisis occurs. Banks and other financial institutions will be forced to increase the quality and the quantity of their reserved capital, according to an agreement reached in Basel by bank supervisors and endorsed by the Financial Stability Board. Another proposed action aims at preventing households from borrowing more than 75–80 % of the values of their houses, giving them space to absorb a future loss of value on their properties.

The G20 Group has under the French Presidency also discussed and initiated actions by many of the UN organizations on issues such as food shortage, commodity prices, immigration, and currency imbalances. The German Chancellor has in another initiative called upon meetings with the leading international organizations to discuss the possibility of a Global Charter to address the current challenges. The result of this initiative has, however, so far been meagre as the organizations seem to have been more focused on defending their respective turfs than on finding common ground.

Some impressive progress has been made by the G20, but the general feeling is that the momentum is fading away as the initial financial crisis is starting to become history and the G20 members are focusing on domestic (and euro zone) consequences of the crisis. Hundreds, if not thousands, of officials from the leading nation-states are still involved in discussions on what actions to take for the future. The problem is that their engagement lacks a clear receiver. As the acute crisis has waned away so has the willingness to take joint long-term decisions.

The former Economy and Finance Minister of Greece Yannos Papantoniou, who has a first-hand experience of a failed economy, is proposing a permanent secretariat of G20 in order to reinforce economic policy coordination. The secretariat should in cooperation with the IMF present world leaders with policy options addressing problems of stability and sustainable growth in the global economy. The immediate task should be to address current account imbalances by promoting exchange rate realignments combined with appropriate adjustments in fiscal policy (Papantoniou, 2011, p. 14). Papantoniou (2011, pp. 10–12) highlights five other remaining issues: Effective Regulatory Framework, Strengthened Supervision, Resolution (The IMF has proposed a “pragmatic approach”), Regulating Systemically Important Financial Institutions (SIFI) and finally Reinforcing Market Infrastructure.

The proposal that originates from ideas floated by the French Presidency can be seen as a pragmatic way forward; it may seem simpler to build upon what has already been created in a “bottom-up” process and not try to create something completely new through a more “top-down” approach. Even this moderate proposal has, however, been met with resistance and it is when this is written unclear whether it will be accepted. The “bottom-up” approach is in the present climate a slow and cumbersome process.

The ambitious work on new financial regulations is also likely to be insufficient to prevent a new crisis. The probable failure is partly due to a too limited scope: The G20 response to the financial crisis has been ambitious, but there are some remaining major issues. One of them is how to attend to *the global imbalances.* One proposal has been to put a “cap” on the current account deficits and surpluses, a proposal that has not been accepted; China and Germany have been the strongest opponents. Many economists have also questioned the cap method, arguing that it can lead to faulty decisions. That something ought to be done about the imbalances is obvious, but how to do it is less clear. The cap proposal has one oddity to my mind – and that is the link to the country level. The most obvious way to correct the imbalances is a structural change in the values of the currencies; it is an approach that is available to China, but not to countries such as Germany and France as they are members of a currency union, the euro zone. I am not here discussing the euro zone questions, as I see the management of the global market economy and a currency union as two very separate questions. A currency union is to my mind a federation of nation-states and should seek solutions as such.[4] It can from this perspective be put in question if it had not been in the interest of the euro zone countries to act as a group in G20 and not to be represented individually. Such a representation would have better reflected their obligations and the reality on the ground.

Others express concerns over *the counter-productive incentive structure* that they claim not to have been addressed. The well-known and interesting libertarian economist Tyler Cowen is one of the critics (Cowen, 2011, p. 9). His main concern is that financial actors are incentivized “going short on volatility”. In his colourful language: “In plain English, this means that some investors opt for a strategy of betting against big, unexpected moves in market prices. Most of the time investors will do well by this strategy, since big, unexpected moves are outliers by definition. In bad times they won’t suffer

[4] Paul Krugman has in an enlightening article developed the striking similarities between the crisis in Nevada and Ireland, as well as the dissimilarities in the handling of them. The losses in the Nevada banks were absorbed on the federal level as the financial system has been seen as a federal responsibility (which seems logical in a currency union) and the support for weaker regions is more extensive in the US. Iht (2010).

fully when catastrophic returns come in, as sooner or later is bound to happen, because the downside of the bets is partly socialized onto the Treasury, the Federal Reserve and, of course, the taxpayers and the unemployed". From the perspective of the "money managers that are investing other people's money.... What's the worst that can happen? Your bosses fire you, but you will still have the millions in the bank.... You may even get rehired at another investment bank, or maybe a hedge fund, within months or even weeks".

Roger Martin, the dean of the Rotman School of Management at the University of Toronto, has in an analysis of the latest crisis put the blame for the faulty incentive structure on a view that became mainstream in the 70's, namely that the managers should focus on maximizing shareholder value. He claims that this is a naïve and wrongheaded linking of the *real market* – the business of designing, making and selling products and services – to the *expectations market* – the business of trading stocks, options and complex derivatives, and he shows how faulty incentive schemes based on this perceived linkage have led managers to take risky short-term decisions that have undermined the creation of long-term shareholder value. He proposes alternative incentive schemes that steers managers towards actions that are beneficial for the companies in the long run (Martin, 2011).

The situation also invites politicians to misread and falsely predict market reactions. The financial markets do not respond to the real market but to the expectations market. In order to stabilize the global financial markets the politicians need to move elements of the markets from insufficient self-regulation to a public regulatory area that is transparent and can be held accountable. Examples: The rating institutes need to be moved into that area and trading practices such as automatic high-speed trading regulated.

An additional problem is *the counterparty risks* that almost sank the ship in the first place and which remain mainly unregulated and without full transparency. The risks with the subprime mortgages were hidden for investors, who many years, based on the ratings from the rating institutes, thought they had invested in something both profitable and safe.

Another concern is the *liquidity* issue. Excess liquidity is driving incautious investments. Such excess liquidity was created by the Federal Reserve, ECB and others during the financial crisis. The purpose was to prevent a lack of liquidity to develop as distrust was spreading and inter-bank transactions dried up. It worked and as long as the money circulation in the global economy has been relatively low the policy is appropriate. But if and when the global economy is starting to pick up, so is the "recycling" of liquidity. If an emerging excess problem is left unaddressed the result can be inflation and new bubbles. The question is how to find a coordinated approach from the central banks in a multi-polar system.

There is to my mind another underlying problem. For several decades the official statistics have shown that the global savings have declined, at the same time as they have surpassed the investments that also have declined. The observation can be passed over as an optical illusion as savings and investments are supposed to match one another at the end of the day, but I believe that the figures signal underlying problems. The reasons are to be found both on the demand and the supply side.

As long as we are in a situation in which the global savings surpass the investments there will be a surplus capital looking for an elusive return. There is a lack of available investments to balance the savings and the market will answer by inflating the values of financial assets and by ‘inventing’ investment opportunities with perceived, but imaginary values. With a surplus of ‘easy money’ there will always be a temptation for someone responsible for capital return to take risks he would not have taken with a better balance between demand and supply; there will likewise be a strong enticement for financial actors to offer products with returns they are unlikely to be able to live up to. The savings and the investments will balance in the short-term, but it is an unsustainable balance. Asset bubbles will develop, they will eventually burst and the values of the savings will have to be written down. This pattern seems to be more or less inevitable as long as we do not have proper global market governance. It also signals another structural problem. If it is difficult to find investment opportunities for savings, mainly driven by people’s wish to secure their pensions, we may end up in a crisis for the pension systems.

The lack of a comprehensive agenda and the limited scope is one of the reasons why the present governance is insufficient. A second severe problem is the *uneven implementation* that is dependent on decisions by the parliaments in every single country. Basel Two has, according the Director General Jonathan Fall in the European Commission, who is a member of the Financial Stability Board, only been implemented as Basel One and a Half in the US. Lord Turner of the British regulator the Financial Services Authority (FSA) has in a testimony to a committee within the British Parliament (Daily Telegraph, February 26, 2009, p. 1) complained that he has been under pressure from the government to apply a light touch regulation and that he was discouraged to intervene before the latest crisis, although the excessive lending culture had created concerns within the FSA.

While economists of the dominating school have revised their thinking, many financial actors have remained committed to the old ways of reasoning. In a well-researched book “Who runs Britain?” (Peston, 2008), the British journalist Robert Peston has given a scathing description on how those actors have been able to steer the actions of the democratically elected government. What has to be recognized is that there is a group that has a vested interest in an unregulated market and this group has not disappeared, even if the scientific basis for its claims has withered away. There is a real underlying conflict of interest between ‘the many’ and ‘the few’.

It is not fair to see the lack of coherent implementation as a pure US-UK problem. The financial actors are resourceful and their heavy-handed lobbying has succeeded to water down the legislation in many crucial countries and to create unfortunate loopholes. Banks and insurance companies may not thrive in an unstable financial climate, but their executives and traders, whose actions are steered by short-term financial incentives, do. Uneven implementation is also creating openings for *regulatory arbitrage*. The only way to avoid this ill-fated situation is to have global governance with legislative powers that can make the threats by financial actors to move their businesses to the country with the least rigid regulation ineffective.

There are other common challenges than the stability of the financial markets. All *externalities* are not automatically taken into account in the global market economy. The most obvious case is the threat to the global environment. Companies are, if not restricted, polluting, destroying rain forests, using scarce natural resources in an irresponsible way etc. The on-going abuse of the environment is pushing climate change, threatening access to clean water on a global scale and exposing large populations in developing countries to poisonous chemicals and hazardous waste. It is more than an urgent environmental issue to internalize such negative externalities in the global economy; it is also a pre-condition for fair competition and fair trade. Other externalities that ought to be addressed are the social conditions under which production is taking place.

The short-comings of the existing governance of the global economy are thus manifold. Some of the problems are

- *Limited scope*. A holistic approach to the world markets is lacking – an approach that covers trade and financial markets in an adequate way, but also e.g. entails the right to buy foreign assets, covers the need for coherent competition rules and an appropriate protection of IPRs as well as addresses the joint responsibility for global climate and environment and regulates the right to exploit valuable and scarce resources in sensitive areas such as the Arctic.
- *Lack of authority*. Most decisions taken on international level need to be implemented on the national level to be enforced and by governments that for different reasons are susceptible to lobbying and “black-mail” from actors who oppose regulation.
- *Lack of transparency*. The populations in general feel excluded from the discussions and are suspicious of the motives of the participants. Meetings are surrounded more by rumours than an enlightened debate.
- *Lack of accountability*. Who is to blame if we enter into a new financial crisis? Who will take responsibility if climate change will become irreversible? In the present situation there is no one to blame, but the more or less unregulated global economy as such.
- *Undermining of nation-states*. The room for manoeuvre by nation-states has declined. Many Western economies are debt-ridden and in difficulties as a consequence of the mismanagement of the global financial system. The rulers have increasing difficulties to act to correct negative externalities when companies and wealthy citizens threaten to vote with their feet.

The present order, which in practice is more of an inter-governmental cooperation than global governance, is too reactive and, to a too small degree, pre-emptive. The leading powers are sometimes surprisingly fast and decisive, but that is basically only when the house is on fire. To build future governance structure that can be pro-active, coherent, transparent and effective on the basis of the existing organizations is an awkward task. What we need is instead, to use the language of the complexity economist Eric D. Beinhocker, to *shape the fitness environment* (Beinhocker, 2006, p. 426) of the global market economy nothing more, and nothing less.

So let us look at the alternatives.

7. De-globalization is not the answer

Those that are against the globalization in its present form are often arguing in favour of a re-nationalization of decision powers, which allows countries to take different externalities into account, protect themselves towards unfair competition, and ensure that each country's social and cultural values can be upheld. The Harvard professor Dani Rodrik, who is critical to the globalization process, is showing that free trade and free movements of capital and people not necessarily lead to a net gain worth pursuing; the losses for vulnerable work forces may be up to fifty times the total gain (Rodrik, 2011, p. 57). He also claims that a total liberalization of the global markets only would add one third of one percent of world GDP (Rodrik, 2011, p. 252, quoting Antoine Bouet).

There are some clear merits in this analysis, but the conclusion that Rodrik draws is to my mind faulty. Renationalization, as proposed by Rodrik and others, was the way the latest globalization period ended, and the protectionism that followed had disastrous effects on the Western economies and deepened the already Great Recession. We should not repeat that mistake. What has been striking me, when reading critical accounts on the emerging global economy, is also the obvious fact that the same critique could have been directed towards the market economy within a country itself. Also within countries, especially if they are large, new companies are started that out-compete less productive old firms; firms whose workforces may end up as losers. Also within countries there may be a difference between private and social costs due to externalities. The difference is that nation-states have the power to address the unintended redistribution of wealth and the negative externalities, while no such mechanism exists on global level; at least most nation-states had that power until the globalization processes and the financial crisis under-mined their independence and toolkits.

8. Self-regulation is no option

A response to the lack of proper governance of the global economy is to claim that there is no need. The economy will, if left to self-regulation, produce a result that will benefit everyone. The proposition is based on a faulty perception of human nature. It was a little more than a hundred years ago that the idea that there is a "hidden variable" in man's actions, that he without always being aware of it, is making rational choices, started to spread. The idea was generally adopted by political economists and influenced both the political right and left.

Contemporary research into human nature is offering an invaluable source of insight to those who want a new perspective on the issues at stake and it exposes the Rational Man as a myth. The findings are putting a parenthesis around the misperceptions of the twentieth century.[5]

Fewer and fewer believe in the Rational Man theory and many centre-right politicians have begun to publicly question the idea that the market economy should be left to self-regulation. The Conservatives in e.g. Denmark, France, Sweden and now the UK have all adopted a more pragmatic stance. The French President Nicholas Sarkozy[6] has started to talk about the need for a "Moral Capitalism" and called upon global regulations of the market economy not only in the field of finance and trade but also in areas such as environment and health. Similar discussions can be found within the centre-left. Many politicians that see themselves as centre-left are just as aware as many that belong to the centre-right that they have to find new ways forward in order to address the present challenges. They are also distancing themselves from the historic luggage, speaking less of socialism and more about an expanded democracy, less about benefits and more about incentives for work and entrepreneurship. They are in the same way as their colleagues in the centre-right looking for pragmatic solutions and feasible ways forward.

9. A new imperial order is not in the waiting

Based on its military and economic status, the US has for a long time had a decisive say on decisions related to the global market conditions. That role has now withered away due to the changing global landscape and the mismanagement of the US economy.

It is far from obvious why the institutions of the Western liberal project have failed to steer globalization in a way that protects the underpinning values, when there still was time. There are several explanations that can be offered, none of which is very comforting. One is an American unwillingness to face uncomfortable facts. The US Congress has refused to acknowledge what many independent observers have warned about the last two decades, namely the inevitable decline of US power due to the lack of a creation of economic values that balances the increasing consumption.

European weakness has, as much as the American hubris, contributed to the present dilemma. The European Union has after all been the largest economy in the world and the largest world trader for quite a while. Individual leaders such as the French President

[5] I have developed some of these findings in Dahlsten (2010).
[6] See e.g. his opening speech at the World Economic Forum in Davos, January 2010.

Sarkozy have in critical moments stepped forward and the creation of the G20 at the emergence of the latest financial crisis, and the actions that he inspired in cooperation with the American, British, and German leaders, was an exceptional show of leadership. But there is no real excuse for the lack of leadership that has prevented the EU as a union to act as one and to use its aggregate economic power to exercise a decisive influence on the global development.

The relative lack of progress in global governance has led to the gloomy prediction (see e.g. Hutton, 2007) that we instead of an End of History[7] will see an ugly struggle for world hegemony between a declining US empire and a rising Chinese super power. There is a perception of an emerging G2, consisting of only the US and China, a development that, however, is vividly denied both in Washington and Beijing. A duo-polar world is, as already described, also to see the development in too simple terms and to miss what is going on in other parts of the world such as India, Brazil and Russia.

That there always will be an imperial power that dictates the global market conditions is based on a faulty reading of history. There are periods when it has been true, but there are also eras with a multi-polar or an anarchic situation.

10. The UN has another rationale

The UN is no alternative. The Security Council has a special task and the votes are based on military power, which is not applicable here. Otherwise, the UN organizations are in principle built upon the idea of one country – one vote. Every single country has a veto, independent of the size of the economy, or whether its governance is commendable or not. How depressing these decision-conditions are has been abundantly clear during the climate change negotiations. It cannot be expected that failed states will give up those veto rights, even if the Group of 20 exercise all its political clout to try to coordinate the actions within the UN family. That all countries should have the same say on the governance of the global market economy is neither supported by the general public.

The IMF has another decision-structure that is more aligned with economic realities, but its scope is limited and the organization has a historic luggage that makes it an unlikely candidate for a wider role.

11. No appetite for a global government

The citizens of most nation-states have historically trusted the elected officials to handle international issues. They have not demanded full information as they trust the politicians to be good patriots and to act in the interest of their country. It is a trust that seldom has been misplaced. The truth is that the lack of demand of information often is stretched further than what the trust requires; people do not always want to

[7] Refers to Francis Fukuyama's famous prediction (see Fukuyama, 1992).

know what their governments are up to, especially if they are using their military power to gain access to other countries' commodities and in the process happen to support a government that abuses its position. But there is a limit to the trust. Citizens are now in many countries turning to extreme parties, mostly to the right, in their anger against what they see as unfair treatment. They perceive that the wealthiest become even richer, that banks, which have failed, are bailed out with taxpayers' money, while the bankers are keeping ridiculously high salaries and bonuses and that the only losers are people like themselves that have to pay for it all through austerity measures. The lack of transparency that earlier was part of the deal between the rulers and the ruled has suddenly become a problem. Many start to believe in conspiracy theories and do not see the truth: That their leaders often are as powerless as they are.

The distrust does not mean that people would support the development of a global government. On the contrary, there is no wish among populations anywhere to have their social and cultural conditions decided on a global level. We may have a global market economy, but there is no appetite for a global society. Citizens in general seem to want the social conditions to be decided as locally as possible. As the European Union has taken over more "umbrella" issues, people ask for a break-down of culturally diverse countries into more independent coherent regions. This has happened in e.g. Czechoslovakia, Spain and Belgium, and Scotland is preparing a referendum on independence.

The nation-states have a central role in creating social conditions in line with the values and the cultural traditions of each country. The anticipations of the populations in relation to the nation-states vary quite a lot, some expecting a welfare state, some a more libertarian state. Research has shown that states of both types can be successful – and unsuccessful – on the global market scene. A more critical issue is how a state manages its public finances, monetary policy and "social capital".

12. Separate system with separate World Market Governance

A common faulty perception is that we have only *one* societal system, *one* 'polity' and that it in the world of today is the nation-state. However, the idea that there is only one level in the political system, one homogenous 'polity', has in practice been abandoned for quite a while. There can in principle be only one constitutional level, which in today's world usually is the nation-state; it has sovereignty and defines more often than not citizenship. But the constitutional level has the possibility to give other societal systems legislative and judiciary powers, and that is what has happened. Nation-states have been broken up into societal systems on different levels that are increasingly independent of one another – city administrations, regions and the like. The nation-states have also joined federations, and bodies with substantial independent power, even legislative power, such as the European Union. Political power is in practice already exercised on many different levels at the same time.

There is another way of seeing the development than an expansion of the public order that is consistent with what is happening on the ground; that is to see the emergence of the global market economy as a societal system in its own right. To regard the global market economy as a societal system that needs its own governance would in practice not be anything completely new. Many financial decisions have already been "broken out" from the decision-making by the nation-states' officials and put under the governance of independent central bankers. In addition, there are already global bodies such as the World Trade Organization and the International Monetary Fund with their own decision-making capabilities.

The market economy as a concept has been a winner on a global scale, and this development has together with the globalization of the financial markets, the IT revolution and the aspirations of the populations in the developing countries been driving the development of an increasingly global market economy. The global market economy can less and less be seen as part of a domestic civil society, on which governments can impose regulations and rules at their will. It is gradually becoming more independent of the nation-states and can be regarded as an inter-linked, but partly separate societal system that needs its own dedicated governance.

The emerging global market economy has a similar justification to the nation-states. It is also a justified societal system[8] and it steers just like the nation-states the relations between individuals and it is central to their life, health and property. The participants have no direct influence on systemic level and no real opt-outs. The territoriality is global and the market economy has de facto coercive powers on systemic level.

The solution to the insufficient governance of the global market economy is thus to my mind rather to accept that it has developed into a separate societal system that although inter-linked with nation-states needs its own governance. Proper global market governance is needed that ensures financial stability, a well-functioning global market economy and a level playing field and that allows nation-states to have their own social systems and make their own decisions on issues such as social conditions, welfare systems, and re-distribution of wealth. That is the approach taken here.

Many have called for such proposals, but few, if any have engaged in a discussion on what more precisely that needs to be done and how to achieve it. I will here shortly discuss how the governance – I call it *World Market Governance (WMG)* – could be structured and how it could come about. It has immediately to be recognized that there is no such thing as the perfect solution, the perfect system, or the perfect world order. There are only "good-enough-ideas" fitting a certain situation, a certain period of time. The world is too complex; man is too complex; in addition the pre-conditions are changing too fast for any solution to be final. The ideas presented here should thus be seen as an input into an urgently needed global conversation.

[8] The analysis from a political science point of view can be found in Dahlsten (2010).

13. World Market Area

The first task is to define the territoriality of the global market economy – a *World Market Area.* To be part of that area a country should meet the requirements that the WTO has set up for a recognized market economy. It also has to agree to abide by the market legislations decided jointly in a community order. A third criterion is that the country should belong to a currency regime that is flexible and convertible so that imbalances within the area can be levelled out.

14. World Market Charter

The *scope* of the WMG would be decided through a Charter. There is clearly a need to stretch the scope further than the areas covered by the present or planned international governance, i.e. trade and to some extent financial regulations. The most urgent issues are related to the financial markets, where a more developed international regulation is absolutely vital if a new meltdown is to be avoided. However, there are many other areas that ought to be covered, such as environmental externalities, exploration of natural resources and consumer and labour protection.

The scope also needs to be restricted; World Market Governance should not interfere in the rights of nation-states to develop their own systems for education, health care and pensions, to honour their own religious and cultural traditions to give some examples. World Market Governance should not be seen as a step towards a global government. The Charter has to be as clear about what is out of the scope of the governance as what is within it.

15. Objectives

The overall objective of the WMG would be to create a long-term stable fitness environment for the global market economy system. To define the components within this overall objective would be a second challenge for the negotiators of a World Market Charter. I would like to highlight six possible objectives.

One important and urgent objective should be to *stabilize the financial markets* as they are a cornerstone in the global market economy that needs proper regulation and oversight to work in an efficient way.

Another objective would be to create conditions for all the countries that are participating in the global market economy to benefit from the globalization process through *fair and free trade* and *access to markets and commodities*.

A third objective would be to create *a level playing-field* for companies and other market actors with as far as possible equal and predictable rules. Basic labour market conditions including mobility also need to be addressed.

A fourth objective could be to enable nation-states to regain some of *their sovereignty to uphold and develop social and cultural conditions* anchored in the national and local traditions. The benefits of the global economy that the few now are assembling has to be shared with the many and the increasing gap between the ‘have’ and the ‘have-nots’ be brought to a halt.

A fifth objective is to take *a joint responsibility* for the world we are living in and to address environmental and health challenges and future scarcity of commodities.

Finally – not all countries are yet part of the global market economy and need help to help themselves. Governments in *developing countries* that govern with the consent of their people need to be supported.

16. Legislative powers

One cornerstone in the WMG has to be *the legislative power.* A weakness of the present inter-governmental order is the lack of coherent implementation.

A WMG with legislative power would need a *Legislative Assembly.* Such an assembly could have several chambers as is often the case in nation-states. One of the chambers in democracies usually represents the citizens in a more direct way, while the other chamber has the purpose of adding to the checks and balances of the system. In federations the second chamber often represents the interests of the different states as is the case in the US and in Germany. The European Union has a similar construction. There are other two-chamber systems. The UK House of Commons represents the citizens and the House of Lords represents both the aristocracy and the meritocracy. This is a reminiscence of the old Republican order with a representation of the ‘many’ and the ‘few’. There are good reasons to be inspired by the model with two chambers, of which one represents ‘the many’ and one gives those with special market positions the confidence that their interests will not be overlooked.

In *the House* the recognized market economies could be represented in relation to their economic strength. A voting power that does not take the populations into account can be seen as unfair, and too much in the Westphalia spirit. It is, however, a much better alternative than veto powers that could block and delay necessary decisions.

To gain support for the WMG from seasoned economists and to ensure that the interest of the ‘few’, those that have the highest stakes in the market economy, is taken into account, one could consider a second chamber, *the Senate.* The senators could be recognized senior experts e.g. central bank governors, regulators, researchers, senior industrial leaders and labour market actors. The Senate could have similar powers to those of the British House of Lords, i.e. it could offer opinions on legislation and in case of difference in views influence or delay a decision by the House. As the process is public the real influence of the Senate can be expected to be larger than the formal one.

There are several advantages with a Legislative Assembly. One is that it is a much quicker way of reaching results than through negotiating new conventions that need ratifications by every single participating nation, another that urgent issues can be addressed in a coherent way without risking incongruous implementation.

A third advantage is the public character and the media scrutiny. Even if people are not represented in a formal democratic way they can follow the debate and they can put pressure on their representatives to act in accordance with their interest when representing them in the Assembly.

17. An independent judiciary

A strong judiciary ensures transparency and a rule of law. As the legislation would have a global reach and therefore be imposed on different levels, local and national courts have to be the first instances, and more often than not the last; not all cases should or could be handled by international courts. The international courts can mostly be expected to deal with complaints by states. Experiences from the European Union show that it would make sense to have two levels of courts within the international system, giving the opposing parties the chance to appeal. The highest court is here called the *International Market Court.*

The role of *prosecutors* should not be underestimated. National prosecutors should have the right to bring breaches of the international legislation to national courts. International prosecutors could support the national prosecutors and address complaints that should be handled by the international courts. They also have to be appointed in a transparent way, perhaps approved by the International Market Court.

18. Executive branch

The WMG also needs an *Executive Branch*. The most important building block in such an organization would be the World Trade Organization; it is the organization that has the most experience of execution. The IMF, FSB, and FSF, organs with oversight over financial services regulations and standards, would also be a natural part, although they would have to be reshaped to fit into a more executive role. Links with other international organizations as the International Labour Organization, ILO, is also desirable.

A less effective, but perhaps politically easier solution is to create a form of *World Market Secretariat* that can support the legislative process, while the IMF and the WTO remains as executive branches.

19. The need for urgent action

There is an increasing perception of *urgency.* Insightful *economists* are progressively more worried about the vulnerability of the global economy and see a need of a robust and coherent regulation of the financial markets. There are also other issues, not least environmental, that need a fast resolution.

World Market Governance would from the perspective of *global business* offer more just and coordinated competition rules, recognized Intellectual Property Rights, a level playing field when it comes to environmental conditions, and more transparency. *Citizens* would benefit from global governance of the market economy that diminished the risk for crisis and financial instability, and a more transparent decision-making on global level that create more confidence in the deliberations and ensure the citizens that also their interests are taken into account.

Nation-states would benefit from global rules that prevent regulatory arbitrage that undermines their finances. They also have reasons to welcome global financial regulations that address unsolved problems, such as the third-party risks and blocks the possibilities for financial actors to play out one country against the other.

And eventually, *world leaders* have to ask themselves if the present mainly reactive approach, trying to address issues in a consensus way as they demand prompt actions, is a good enough way of addressing the challenges ahead, if a G20 that has lost some of its steam and Basel agreements that are implemented in an inconsistent way will prevent a new financial crisis and address the regulatory arbitrage that is increasing the gaps between the have and the have-nots as well as undermining the public finances of nation-states, or if not something more proactive is needed to steer the growing and increasingly independent global market economy.

To conclude: There is an urgent need for effective, coherent and transparent governance of the global market economy.

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