

# WORLD MARKET GOVERNANCE THE ALTERNATIVE

How an International Rule of Law can reap the benefits  
of the Global Market Economy and strengthen National  
and Regional Sovereignty

## DISSERTATION

zur Erlangung des akademischen Grades  
Doktor der Wirtschaft- und Sozialwissenschaften  
(Dr. rer. pol.)

in der Wissenschaftsdisziplin Soziologie

Erstgutachter:

Prof. Dr. Carlo C. Jaeger

Zweitgutachter:

Prof. Dr. Erhard Stölting

eingereicht an der

Fakultät für Wirtschafts- und Sozialwissenschaften

der Universität Potsdam

von

Ulf Dahlsten

London, den 30. Juli 2012(rev. den 1. September 2013)

This work is licensed under a Creative Commons License:  
Attribution - Noncommercial - Share Alike 3.0 Germany  
To view a copy of this license visit  
<http://creativecommons.org/licenses/by-nc-sa/3.0/de/>

Published online at the  
Institutional Repository of the University of Potsdam:  
URL <http://opus.kobv.de/ubp/volltexte/2014/7016/>  
URN <urn:nbn:de:kobv:517-opus-70168>  
<http://nbn-resolving.de/urn:nbn:de:kobv:517-opus-70168>



## **ABSTRACT**

Democratic capitalism or liberal democracy, as the successful marriage of convenience between market liberalism and democracy sometimes is called, is in trouble. The market economy system has become global and there is a growing mismatch with the territoriality of the nation-states. The functional global networks and inter-governmental order can no longer keep pace with the rapid development of the global market economy and regulatory capture is all too common. Concepts like de-globalization, self-regulation, and global government are floated in the debate. The alternatives are analysed and found to be improper, inadequate or plainly impossible. The proposed route is instead to accept that the global market economy has developed into an independent fundamental societal system that needs its own governance. The suggestion is World Market Governance based on the Rule of Law in order to shape the fitness environment for the global market economy and strengthen the nation-states so that they can regain the sovereignty to decide upon the social and cultural conditions in each country. Elements in the proposed Rule of Law are international legislation decided by an Assembly supported by a Council, and an independent Judiciary. Existing international organisations would function as executors. The need for broad sustained demand for regulations in the common interest is identified

## PREFACE

The global markets have in many ways outgrown the reach of the nation-states. The market economy system is a global winner, but the way the system is managed needs quite urgently to be improved. Global leaders know it, but they do not have the tools to take charge.

There are two sides to the challenge. The first is that the market economy is still fettered with chains to old structures from which it has to be liberated. Many emerging and developing countries have to confront their traditional ways of doing things to fully capture the opportunities of industrialization and globalization, and the Western world has to critically examine the remaining hindrances to competition, faulty incentive structures, insufficient innovation and the need to revive demand policies as it struggles to recover from the latest crisis and to keep its competitive edge.

The second side to the challenge is that markets, especially the financial markets, need to be properly regulated to create fair and stable conditions and a level playing-field, and that it has become more and more difficult for the public order to keep that oversight as the markets have grown and turned global. And this is a predicament to be taken as seriously as the first side of the challenge.

Europeans learned the hard way that capitalism is a force that needs custodians as the wave of industrialization swept over land and across borders a hundred and fifty years ago. Unchecked capitalism led more often than not to the abuse of some workers, while others were left unemployed, to an unreasonably skewed distribution of income and wealth, to tendencies to establish monopolies and block competition, and to over-exploitation of the environment and natural resources. These drawbacks fuelled in many countries a popular reaction that inspired the development of the modern democracies and the creation of labour unions that could balance the destructive features of capitalism, and an uneasy marriage developed in the Western world between the political, economic and judicial systems.

The political system quite rapidly established the upper hand in the marriage, but lost that to an increasingly global financial casino economy a hundred years ago during a globalization period driven mainly by colonialism. Historians have shown how this loss of stewardship contributed to two World Wars and the Great Depression.

The politicians and economists of the time learned their lessons. A partly supranational regime with strict controls of the financial markets was established after World War II, demand policies were implemented and what followed were decades of a relatively happy marriage between growing and innovative markets, and a political system that ensured that the progress was shared by all. But the insights gained by earlier generation of economists faded as time passed and so did the belief in the post-war focus on financial regulations and the demand-side of the economy. The developed economies had become less flexible and no longer responded the same way to actions that stimulated demand. A more market-liberal economic philosophy gained ground and it focused more on how to improve the supply-side of the economy through deregulations and better incentives. As the paradigm shift swung the pendulum the new generation of politicians and economists decided to liberalize the financial markets on a global scale in the seventies, without any supranational structures, any global

regulations, any global regulator, any global central bank or any lender of last resort in place. It was a tragic mistake and the consequences have come to haunt us. The major political parties in the US and in Europe that were involved in this decision have still to admit that the deregulation of the global financial markets was to take one step too far and have yet to draw the necessary conclusions.

While the globalization process has lifted hundreds of millions out of poverty, a progressively disturbing effect has been that the global markets, and especially the financial market, have regained the upper hand in the relation to the political system. The order of power is reversed and we see, just as a hundred years ago, the rise of somewhat of a systemic crisis.

It shows up in a couple of ways:

The first is in the form of recurring financial crises. An insufficiently regulated financial system is prone to excessive pro-cyclicality and bubbles. We have had more than 400 crises since the large deregulation in the 1970's, of which the 2007-2008 crisis has been the most serious. The question is no longer if new crises will happen, but how often and how serious they will be.

The liberalization of the financial markets also contributed to an unreasonably skewed distribution of income and wealth within countries. A lesson learned a hundred years ago is that a financial casino economy is driving inequality and we see the same pattern repeat itself. The lack of global market regulations has also enabled wealthy citizens and global companies to illegally evade taxes and, perhaps more importantly, legally avoid them.

However, the mounting inequality is not due only to an unmanaged globalization process; it is also an effect of misguided national economic policies. A modern market liberal misperception is that a concentration of wealth to the small group of citizens, who are the most active as investors, will lead to the building of production capacity and thereby more growth and jobs. Experience has shown that such investments in the real economy only will take place if there is a general demand, driven either by the vast majority of the population or by the public sector. Without such a demand the investors will turn to more profitable short-term financial investments that, rather than create jobs, may drive bubbles. The combination of these policies and the financial casino economy has had the effect that the middle class in the Western world has had almost no increase in real income for thirty years, while the top 1-to-5 percent has made fortunes and has continued to make fortunes also after the 2007-2008 crisis. To keep up demand the Western countries turned to borrowing already in the seventies, sometimes recklessly, and later, more or less deliberately, encouraged citizens to borrow too in order give them a feeling of progress. After the latest rescue of the banks and the increased public debt this route has become unsustainable. To run their budgets with deficits may be the only available alternative to many governments in the short run, but it is no long-term solution.

The effect of the lack of demand from the broader populations is that the economies have stagnated and that mass unemployment has started to spread. One out of four Spanish young men and women has stopped looking for jobs all together, one out of five Italian and one out of six French.

To turn the economies around requires a combination of supply-side and “smart” demand-side policies. There is a need for national and regional policies that ensure a more fair distribution of income and wealth, support innovation, public investments for a future sustainable economy, efficient competition and a flexible, but secure labour market at the same time. It is up to every country to find its own way, but none of their actions will be enough to get the Western countries as a group out of the present gloom. For that to happen there is a need to improve the control of the global markets, especially the financial markets, not at least in order to create fair and sustainable conditions.

Finally, the lack of proper worldwide market governance also shows up in the form of insufficient reactions to environmental threats. Global leaders have not been able to agree upon the responses to climate change and to energy, food and water shortages, and the market actors are as a result not been held fully accountable for the environmental costs of their activities.

Not all recognize the threat of a systemic crisis as they have benefitted more from globalization than they have suffered from its drawbacks. But almost all have in one way or the other started to be affected.

The challenge we all share is that the market economy has become global, but that the present networked, mainly piecemeal and functional, global governance, in which there is no one responsible for the common interest, is unable to respond to the need for concerted actions. The present order has become somewhat of “multilateralism a la carte.”

Most global leaders know that there is a need for international law and order in the global market economy for all to capture the benefits of globalization. But they are responsible to their national constituencies and have to face heavy handed lobbying from vested interests with financial resources. They cannot expect to act if there is no concrete proposal and if they do not perceive a broad public demand. To fill the vacuum we need an informed debate and an alliance for change. Such an alliance has to involve insightful political leaders, central bankers and regulators, the civil society and the business community, non-governmental organizations (NGOs) and global networks as well as think-tanks and researchers.

However, such a public demand for change is not enough. There must be an institutional supply. International regulation of the global market economy in the common interest demands proper and transparent governance structures. There is a need for minimal World Market Governance. In this thesis I discuss the theoretical foundations, why we are where we are and the shortcomings of other alternatives to end by developing a concrete proposal on how such governance can come about. It starts in a process leading to a World Market Charter signed by recognized market economies. The scope is restricted to the four most important areas, on which I also believe most people can agree – international financial regulations, domiciliation of income, global competition rules and environmental laws. International laws and regulations are, based upon evidence and global and public reasoning, proposed to be decided by an Assembly in which countries are represented in relation to their role in the global market economy. A Council, to which the civil society, global networks, NGOs, researchers and seasoned experts have nominated members, is ensuring a transparent process in the common interest. There is also a need for an Independent Judiciary to ensure

compliance. Existing Intergovernmental Organizations (IGOs) have in my proposal an important role to play in the preparation of legislations as well as in the execution and monitoring. They can add missing executive institutions to their scope.

*Ulf Dahlsten*

## **ACKNOWLEDGEMENTS**

I am grateful to the Potsdam University and to Professor Dr. Carlo Jaeger for accepting me as a scholar. Thanks also to the European Commission, which has allowed me to concentrate on this topic, which I started working on during a sabbatical in London. 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. I thank them all for sharing their concerns and experiences with me.

A special thanks to Professor Nancy Cartwright at the Centre for Philosophy of Natural and Social Sciences at London School of Economics for giving me the opportunity as a Research Associate to benefit from the resources of the Centre. I would like to acknowledge valuable comments and inputs from Professors Erhard Stölting, Ivana Markova, Dennis Snower, Bo Rothstein, Daniel Tarschys, Nils-Goran Olve and Lord Desai.



## DECLARATION ON RESEARCH PROGRESS

The research, on which this thesis is based, started in 2000-2001 when I was accepted as Research Associate at the Centre for Philosophy of Natural and Social Sciences at London School of Economics. I wanted to better understand the relationship between human nature and the political and economic systems and especially why human expectations, in my own experience, change so dramatically when a function is moved from one system to the other. My interest in human nature goes back to my master thesis in economics, rewarded with a first, which was about the value of human life in theory and in practice. The work exposed some interesting inconsistencies.

I left the research I had initiated in London as my career took another direction, but I returned to it during a sabbatical from the European Commission in 2008-2010 (during which I also was working for the UK Government on deregulations). I became more and more convinced that the idea of The Rational Man is a too simplified understanding of human nature and that the idea has lead economists and political scientists to faulty conclusions. The findings around the contemporary understanding of human nature inspired me to reflect upon possible applications and I sketched upon some ten areas of interest for research and public policies. When I returned to the Commission I asked about the possibility to continue to work on those ideas and see if some of them could be realized. I was allowed to do that and was given the necessary resources. My findings and some of the sketchy proposals were published on the web as a policy input into the Information Society policy programme of the time, i2010. (It is now deleted from the EC web, as the Commission has moved on to a new policy, The Digital Agenda, but I have for the purpose of transparency asked the think-tank Global Utmaning, in which I am a Senior Advisor, to republish it on its web<sup>1</sup>).

During this final year in the Commission I organized internal workshops with officials to make them aware of the contemporary understanding of human nature and how it could affect their way of thinking and working.

One of my policy proposals was that researchers in economic and other global models ought to be able to move from inadequate theoretical models to more complex models that give a better representation of the economic and other systems. The emerging eScience, I suggested, would enable the researchers to take the progress in life sciences into account. To stimulate the interest, I organized workshops with modellers in universities and institutions, such as the International Monetary Fund and central banks, and pushed for the development of a new research area, Global Systems Science and for funding by the EU. It is now a rapidly growing community that still needs to find its ways, but it has made considerable progress.

Another sketched conclusion in my paper was the important role of a Public Information Space for democracy and that it has to be adapted to the new information society. There are now research programmes with that direction, but the findings have not, at least not so far,

---

<sup>1</sup> Dahlsten, 2010

affected public policies. On the contrary, the space has in practice become more restricted in many EU countries.

A third sketched conclusion was that the Judiciary system should be separated from Security services. A prime purpose of the Judiciary system is to ensure reason-based decision-making in the appliance of laws, while demands for security often are driven by fear. Subconscious fear is in conflict with logical reasoning; it may even block reasoning, I had found. More concretely, I suggested that the existing Commissioner position for the Judiciary and the Security ought to be split into two independent positions. My proposal was well received by the Commissioners concerned and by the Swedish Presidency of the EU at the time, which had the responsibility to negotiate the design of the new Commission and it may have contributed to the final, positive outcome.

One of the draft proposals concerned the governance of an increasingly global market economy. My main two arguments were that the global market economy had outgrown the reach of the nation-states, and that the market economy and the public order related to different human features. As the financial crisis evolved the issue started to be of more and more interest and I was allowed to develop my thinking and discuss it with interested parties.

During an intensive period I travelled twice to Washington and met with the President of the World Bank Robert Zoellick, the Director for Regulatory Affairs in the Executive Office of The US President, Cass Sunstein, and the neo-conservative think-tank the American Enterprise Institute. I travelled twice to Paris to meet with the Secretariat of the G 20 and with the Chief Economist of the OECD Pier Carlo Padoan; I now know that President Sarkozy brought the ideas to a meeting with the G20. In Singapore I met with the Executive Director of the Asia-Pacific Economic Cooperation and in Beijing with several researchers and with the former Chief of Staff of the President, now Senior Advisor in the Think Tank under the State Council Ding Ning Nin. In Geneva I met with Chief of Staff to the Managing Director of the World Trade Organization Arancha Gonzalez.

All these meetings added to my understanding of the issues, but also raised questions that needed to be addressed. As my year in the EC started to get to its end (I was to retire) I was encouraged by Professor Carlo Jaeger to continue the research work I had started, develop the sketch on World Market Governance and evaluate it in relation to research in the appropriate fields. I applied to the Potsdam University and was accepted as a PhD student.

The work on the thesis has been built upon another logic than the paper I had worked on in London. I have used about one third of the findings around human nature and I have had them verified by the recognized social psychologist, Professor Ivana Markova. I have the ambition to develop a paper on The Myth of The Rational Man for scientific publication at a later moment of time and all my findings are “parked” in a draft on the website of Global Climate Forum.<sup>2</sup> I want to develop the descriptive, normative and evaluative aspects and I am now receiving comments from researchers on the draft.

But the findings around human nature are not the starting point for this thesis. It is instead the development of the political and economic systems and their interrelation. In the thesis I have

---

<sup>2</sup>Dahlsten,2011

a multidisciplinary approach and have been inspired also by sociology, political science, economics and research in international relations. I am grateful to colleagues who have helped me in this respect, besides to Professor Carlo Jaeger, especially to the political scientist and former Secretary General of the European Council, Professor Daniel Tarschys, to the economists Professor Lord Desai and Nils-Goran Olve and to the sociologist Professor Helga Weisz, who brought the works of Professors Niklas Luhmann and Theresa Wobbe to my attention.

I have also deepened the reasoning around democratic capitalism or “embedded capitalism”, to use the language of Habermas, and how it has developed especially during the crisis a hundred years ago, and I have found interesting insights expressed by Peter F Drucker and Friedrich Hayek.

Luhmann’s understanding of the conditions for a World Society and an unlikely World Community seems to me to be supported by my findings around human nature and I have tried to show how this is the case.

My discussions with representatives for Inter-Governmental Organizations and major countries have convinced me about how important it is to recognize the alternatives. I have tried to do that and I have made a special effort to discuss the alternative favoured by many, namely de-globalization. Professor Dani Rodrik has developed a concrete proposal and I have at some length and detail analyzed it and what I see as its shortcomings.

Others have pointed out that I have to recognize the development and important role of functional global networks. The recent works of Professors Miles Kahler and David Lake have been enlightening. The British Prime Minister David Cameron sees in a paper written for the Group of 20 more networking, bench-marking and monitoring as the way forward. There is no lack of institutions, but of political will, he claims. Therefore, I have tried to describe how the present inter-governmental has developed into a multilateralism a la carte in which vested interests have an undue influence. In this respect the recent research by Professors Ngaire Woods and Walter Matttli on regulatory capture and the preconditions for regulations in the common interest has added substance and evidence to my thesis.

Their research has also inspired me to develop what would be a ‘good circle’ for world market governance in the common interest, in contrast to a ‘vicious circle’ with regulatory capture by vested interests. In the good circle, the thinking of the Nobel Prize Winner Amartya Sen on Global reasoning has a prominent place.

Besides at Potsdam University, I have presented and discussed my thinking around World Market Governance at workshops with researchers and policy-makers in Global Systems Science in Barcelona, Brussels, and Berlin, two academic seminars with philosophers in London, one lecture at the Beijing Normal University, an international conference of sociologists in Denmark, a plenary and workshop with global decision-makers organized by the Tallberg Foundation, and workshops organized in Malmoe and Stockholm by the think-tank Global Utmaning.

This thesis is not the end of the research. It discusses why World Market Governance is a desirable alternative, how it can come about and what it could look like. I have already started

to work on the questions on what it could achieve in the four areas identified in the thesis, global financial markets, domiciliation of income, competition rules and internalization of environmental impacts into the economic system. I have been Senior Fellow for two months at The Institute for Advanced Sustainability Studies at their Financial Markets Group, where also an international workshop was organized. I am now organizing a major event in Stockholm on the sustainability of the financial system together with the Financial Markets Group at the London School of Economics, The Stockholm School of Economics and The Institute for Graduate Studies in Geneva.

Thus, while the thesis is built upon a sketch in an earlier paper, the thesis follows another logic and increased knowledge and feedback from researchers and practitioners has influenced the thinking that has, as described, developed in a substantive way. Some findings in the EC policy paper have not survived, been found unsubstantiated or superfluous. Of the findings, which I have used here, many, following my own scrutiny and comments by others, have been slightly altered, qualifications may have been added or the language has been improved. In these cases I have for the purpose of transparency made a reference with the German “vgl” in the main text (not in the introduction that is a guide to and a summary of the thesis). I have used quotations mark when text from the sketch has “survived” unchanged.<sup>3</sup> This is somewhat incorrect as the context is different and the earlier work was a policy input that never has been peer reviewed or intended for scientific publication. In fact, this is the first time those findings are put forward for more formal academic scrutiny.

---

<sup>3</sup> I have generally added the German term “vgl” to a source when I have made a concentrated summary and “See” when I have made a superficial reference. I have no references in the introduction, as it is a summary giving the reader an overview of the work. Exceptions are quotes that are not in the main text.

# TABLE OF CONTENT

ABSTRACT .....	2
PREFACE .....	3
ACKNOWLEDGEMENTS .....	6
DECLARATION ON RESEARCH PROGRESS.....	7
<b>I. INTRODUCTION .....</b>	<b>13</b>
The legislator.....	27
<b>II. THE GLOBAL MARKET ECONOMY – A WINNER GAINING GROUND.....</b>	<b>32</b>
The market economy – a winning model .....	33
Emerging global markets .....	35
<b>III. THE PUBLIC ORDER AND GLOBALIZATION... 38</b>	
1. SOCIAL SYSTEMS AND THE WORLD SOCIETY .....	39
Parsons .....	39
Luhmann.....	42
The theories on world society, world polity and world systems .....	43
Community or society .....	43
The evolving world society, global networks and global governance .....	44
2. THE ROLE OF THE NATION-STATE.....	47
The rationale for the state.....	47
Regulations in the common interest .....	50
The modern nation-state.....	51
The nation-state is not the only societal system with coercive powers.....	53
<b>IV. A MARRIAGE IN TROUBLE .....</b>	<b>55</b>
Democratic Capitalism -a marriage of convenience .....	55
The Return of Un-Checked Capitalism .....	60
Liberalized financial markets .....	65
The Second Return of Un-Checked Capitalism .....	67
Many consequences.....	77
Lessons to learn? .....	83
<b>V. INSUFFICIENT INTERGOVERNMENTAL GOVERNANCE .....</b>	<b>85</b>
Multilateralism a la carte.....	86
What the global market economy is lacking .....	89
An order at the end of the road.....	90
<b>VI. THE IMPROPER, INADEQUATE OR IMPOSSIBLE ALTERNATIVES.....</b>	<b>92</b>
1. RE-NATIONALIZATION IS NOT THE ANSWER .....	94
2. A NEW IMPERIAL ORDER IS NOT IN THE WAITING .....	100

Military power and the global market economy .....	103
The rise of China .....	103
3.    SELF-REGULATION IS NO OPTION .....	105
The emergence of The Rational Man .....	106
The invisible hand .....	107
The meaning of rationality .....	109
Two different ways of reasoning .....	109
The powerful self-justification process .....	114
The market does not demand rationality .....	115
The death of the Myth of The Rational Man .....	115
The need for a developed understanding of the economy .....	118
4.    NO APPETITE FOR A GLOBAL GOVERNMENT .....	120
The dream .....	120
Man in the philosophical tradition .....	121
The struggle for recognition .....	123
Group identity .....	124
No global community .....	126
No common value base .....	128
Democracy is a vulnerable concept .....	129
The UN is no alternative .....	130
<b>VII. THE JUSTIFICATION OF WORLD MARKET</b>	
<b>GOVERNANCE .....</b>	<b>131</b>
The purpose of the World Market Governance .....	133
The global market economy – a separate fundamental societal system .....	133
The indispensable nation-states .....	136
<b>VIII. OBJECTIVES .....</b>	<b>140</b>
<b>IX. THE RULE OF LAW – A CENTREPIECE .....</b>	<b>142</b>
An independent Judiciary .....	143
The Rule of Law meets most objectives .....	144
International execution sometimes necessary .....	144
<b>X. LEGITIMACY .....</b>	<b>145</b>
Value base .....	148
Key values .....	150
Equality - a contentious value .....	152
A legitimate process .....	157
<b>XI. THE LEGISLATOR .....</b>	<b>160</b>
Guardianship .....	161
The few and the many .....	164
Republicanism .....	167
The Assembly .....	168
The Council .....	170
<b>XII. WORLD MARKET CHARTER .....</b>	<b>170</b>
<b>XIII. PRACTICAL EXAMPLES .....</b>	<b>172</b>
A functioning financial market .....	172
Trade .....	173
To buy assets .....	174

Competition, intellectual property rights and sound trading practices.....	175
The market actors and the environment .....	175
To tax the wealthy and avoid regulatory arbitrage.....	176
The conditions for the developing countries .....	176
<b>XIV. BROAD AND SUSTAINED DEMAND.....</b>	<b>177</b>
<b>XV. REFERENCE LIST .....</b>	<b>183</b>

## I. INTRODUCTION

The world economy has just survived the worst financial crisis since the Great Recession, at least that is what we hoped until recently, but it has also turned a corner in a very literal way. It is on a new road and there is no way back to business as usual. The Western economies, whose laid-back regulation of the financial markets and relaxed financial policies created the crisis in the first place, have surfaced debt-laden and significantly weaker than before the financial meltdown and they are now facing a new, more austere, reality. In the crisis the consequences of which will live with us for decades to come all were losers, the winners only winners in relative terms. China and other emerging economies seemed to pull through rapidly, while the economic recovery in most Western economies stutters. Some countries in the Euro zone face a sovereign debt crisis that is contaminating the economies of neighbours and trading partners. Steps are taken to solve the most urgent debt issues and more of a community order with decision power and accountability has been introduced in the Euro zone in order to force a more coordinated financial and economic policy. There are some economic star performers also in the European Union, but they are just like the other members of the Western hemisphere embedded in a global play without a proper script or an identifiable director.

Many see a parallel to the end of the first modern globalisation period. It had other characteristics, driven by colonialism and exploitation by military means of weaker countries, but it ended in a way that has alerted some economic historians. 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”<sup>4</sup> 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 us are serious, but there are glimpses of light. The whole world economy is not in a dire state. The 2008 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. The benefits of industrialisation 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 new-borns 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. However, that the picture is multi-faceted should be no excuse for inaction. 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. The up-rising in many Arab countries should be seen in the light of the food crisis, decreased living standards for the majority and increasing gaps between a wealthy few and the citizens in general. The global problems are piling up and the existing world order seems to be unable to address many of them in a satisfactory way.

### **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

---

<sup>4</sup> Floyd Norris, International Herald Tribune 11 March 2011



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 global governance 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 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. (Chapter II: section 1)

### **The emergence of a global market economy**

Companies are increasingly globalised. 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 market their products and services with a local flavour, adapting to different cultures and customs. The steadily improved 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 loser 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 globalisation 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. Of the Chinese export 55 per cent is 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 per cent of the worldwide output of minerals and other commodities. (Chapter II: section 2)

### **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 2004 about three trillion dollars of which less than one trillion dollars were to be found in the Chinese reserves. 2010 the global currency reserves had reached nine trillion dollars of which three trillion dollars were 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. 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. (Chapter IV: section 3)

### **Declining national power**

The bottom-up market economy system needs just like a good game of soccer fair and transparent rules and a judge to see that the rules are followed. The soccer players do not need committees sitting on the side-line directing them 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 the lack of globally accepted rules and proper surveillance starts to be apparent. The problem is serious as the global scale has made the economy not only more dynamic, but also more vulnerable.

If the nation-states cannot ensure that the economy is governed in an acceptable way the populations often direct their anger towards the rulers, as seen lately in Northern Africa and in several Euro zone countries. But such protests are increasingly in vain if the nation-state is a country dependent on trade and lenders, and integrated in the global economy. The governments may wish that they were in control and that they could deliver on the expectations of their people, but they increasingly find that their scope of action is limited by the economic environment in which the country finds itself. The globalisation of the market economy is putting more and more restrictions on what a government can do and cannot do. Financial actors, global companies and wealthy citizens have been able to exploit the situation and benefit from ‘regulatory arbitrage’, i.e. use the different implementation of financial and other rules in various countries to avoid control and taxes. The sovereignty of nation-states is slowly but irrevocably under-mined by the regulatory arbitrage that dilutes their finances and a process that is making countries and their economies increasingly interdependent (Chapter III section 2, Chapter IV: section 1).

### **A World Society but no World Community**

German sociologists have developed a societal systems theory that is helpful in the analysis of this development. They make a distinction between *Gesellschaft*, society, and *Gemeinschaft*, community. Sociologists of other schools, such as the one established by the European-born, American sociologist Talcott Parsons, define social systems and society in terms that include both the functional and the communal aspects. When socioeconomic researchers, such as the Nobel Prize Laureate Elinor Ostrom, have identified the success factors behind sustainable self-organized local communities they have also found both such functional and community-building factors. However, it would be a mistake to extrapolate those findings on local level to a more global level. Parsons and other researchers of similar schools have, and rightly so, been criticized for their over-emphasis on shared values and shared interests and many have pointed out that there are built-in conflicts in the capitalistic system that drives the interests of different groups and individuals apart.

The thinking of the German sociologist Nicholas Luhmann is helpful in understanding the underlying tendencies. Luhmann saw the emergence of a World Society some five hundred years ago. That is when the territorial boundaries for communication, which is the key driver of societal systems in his view, broke down. As societies develop, the functional systems become more and more important. That is what we see on a global scale. Old imperial orders that remain from earlier phases have lost their power, the emerging supranationalism following World War II is halted, even in decline, while global networking, mainly in the form of functional societal systems, is surging.

There are two important observations to be made. The first is that the development of a World Society has not been accompanied by the rise of a World Community. I have in this thesis given a considerable effort to the task of showing why this is due to human nature and why a World Community is unlikely to ever develop.

The second observation is that this development is a fertile ground for regulatory capture of vested interests. Researchers in International Political Economy, such as Ngaire Woods and Walter Mattli, have shown that regulation in the common interest demands extensive institutional supply and a broad sustained demand.

It is about power. Luhmann sees power as a success media in the political system. But it does not exist only in that system. Power as a success media plays a role also in other systems and in the interaction between systems. The capitalistic economic system was initially more or less unchecked by the political system. The consequences were that some workers were exploited, while others were left unemployed, a skewed distribution of income and wealth, the creation of monopolies, and a misuse of nature and its resources. The political system started to exercise power over the economic system, putting up restrictions and setting boundaries. It worked well until the first globalization period a hundred years ago. International functional networks became more powerful than national political systems and un-checked capitalism returned. The order of things was restored after WWII and an uneasy marriage between the political system and the economy system once again developed. In the Western hemisphere the marriage has been called democratic capitalism or liberal democracy. It is that marriage that now, once again, is in trouble. (Chapter III:1)

### **Inter-governmental order at the end of the road**

The political system admits in principle only one constitutional level, which in today's world usually is the nation-state. It has sovereignty and is more often than not defining citizenship. The constitutional level has the possibility to give other societal systems legislative and judiciary powers, and that is what has happened. Nation-states have given such powers to other societal systems such as regions and cities through law and to international institutions through treaties.

Nation-states have been broken up into societal systems with legislative and coercive powers 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 exercised on many different levels at the same time. Many financial decisions have 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. To regard the global market economy as a fundamental societal system from which there is no real opt-out and that needs its own governance would in practice not be anything completely new.

The partly supranational structure that was created after WWII with the IMF at the centre regulating the global financial markets was dismantled when the Bretton Woods system was abandoned in the seventies. The existing institutions, the WTO, the IMF of today and the like, are basically inter-governmental and have two weaknesses. They mostly demand unanimity among the nation-states to reach decisions and have therefore had difficulties to address the global issues in a proactive and decisive way. And, secondly, most of the agreed actions are dependent on an often uneven implementation by the individual states.

That the inter-governmental order is insufficient has been commonly recognized. The G20 was created as 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. And 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 short-comings of the existing governance of the global economy are thus manifold. Some of the problems that will be highlighted in Chapter V 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 Intellectual Property Rights (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. There is no one to blame if we enter into a new financial crisis. There is no one to take responsibility if climate change will become irreversible. In the present situation there is no one else to blame, than the more or less unregulated global economy as such.
- Undermined 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.

There are proposals tabled on how to strengthen the present order, but they are incremental. The former economy and Finance Minister of Greece, Yannis Papantoniou, proposes in a report a permanent G20 secretariat to, in cooperation with the IMF, deepen the analysis around performance issues in the global economy. The British Prime Minister David Cameron has on behalf of the G20 worked on proposals how to strengthen the global governance through more of voluntary coordination. Other tabled proposals concern the balance of power in the IMF and the implementation of financial regulations. These "bottom-up" approaches are welcome, but they do not address the need for effective, comprehensive and transparent governance.

### **The rise of a systemic crisis**

Peter F Drucker and Friedrich A von Hayek have in two ground-breaking books analysed the systemic crisis of the 20's and 30's that led to the emergence of fascism and National Socialism in Europe. What makes their contributions especially interesting is that the books were written before the victors rewrote the history, in Drucker's case before the war and in Hayek's case when it was still on-going. They both saw the breakdown of trust in capitalism and in democracy as the main reason for the emergence of the totalitarian systems, even if they differed in their view on the importance of the ideologies. Drucker focused on "the despair of the masses" and saw the permanent high level of unemployment as the main factor behind people's rejection of capitalism and democracy, not the attractiveness of the alternatives.

Are there reasons to reflect upon those historic experiences? I believe so. The visible losses that taxpayers have been forced to take over have been created in a financial system in which the actors have continued to distribute excessive remunerations and bonuses among themselves, also after they have been saved by the taxpayers. In Europe 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 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. In Latvia, where the population is suffering under severe austerity measures, only a minority continues to believe democracy to be a good system and only 14 per cent support the market economy system. Anyone who has been in Greece lately has heard people talk openly about how better things were when the military junta run the country.

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 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 bankers are protected 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. (Chapter IV: section 4, 5 and 6)

There are many ideas on how to proceed to get out of the present situation, but they are to my mind improper, inadequate or impossible.

### **Re-localization is not the answer**

In chapter VI:1 I discuss de-globalization. There are many who argue in favour of a re-nationalization of decisions concerning finance, trade and other market economy issues. Their view is that the negative externalities of the globalisation outweigh the benefits. They also see the risks for a new financial meltdown, this time leading to a severe global recession. Dani Rodrik has in a new book developed the arguments and how a re-localization could come about. I have analysed his reasoning and have come to the conclusion that de-globalization is not the right answer to the present problems. Rodrik's solution is unstable and can in worst case lead to a repetition of the mistakes that were made at the end of the globalisation period a hundred years ago.

### **A new imperial order is not in the waiting**

It is far from obvious why the institutions of the Western liberal project have failed to manage globalisation in a way that protects the underpinning values, when there still was time. The Western world with all its military resources, economic strength, innovative entrepreneurial culture and lessons learned from two World Wars ought to have been capable of using its position to create an international order and institutions that would have prevented the present failure to address pressing world issues.

The US has been the leader of a global American Imperial Order, the 'Pax Americana', for quite a while and still plays the leading role in addressing world conflicts. The US leading position is backed up by a supreme military power. Some call the US, not without merit, for the 'indispensable nation' when handling outbursts of violence in and between nations.

But the US is no longer the unchallenged leader of the global market economy. Many of the latter US Presidents have been aware of the duality of the situation and the need to involve other countries in order to address the global market governance issues, but have failed to get

the necessary mandates from the US Congress. There are two reasons behind the reluctance of the US Congress. The first is an unsubstantiated belief in totally deregulated markets, for which the whole world had to pay a dire price at the latest financial crisis. The other is a Congressional hubris and an unwillingness to face uncomfortable economic facts. The relative lack of progress in global governance has led to the gloomy prediction that we instead of an End of History 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.

The European Union has been the largest economy in the world and the largest world trader for quite a while and individual leaders have in critical moments stepped forward. The creation of the Group of 20 at the emergence of the latest financial crisis, and the actions that the French President inspired in cooperation with the American, British, and German leaders, was an exceptional show of leadership. But there is a stark contrast between those individual efforts and the lack of collective 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 vacuum that the waning Western leadership is creating will not automatically be filled by China. The Chinese have a realistic view on their role in the world. They know that they cannot match the US militarily, at least not for many decades to come; they know that they are far from the only emerging economy and that demographic factors speak in favour of a 'multi-polar' world. The close cooperation between China, India, South Africa and (often) Brazil should not be seen as a tactical move but rather as a strategic positioning in a world in which several emerging economies will play a major role. To see China as the next imperial power is to see the development in too simple terms and to miss what is going on in other parts of the world. (Chapter VI:2)

### **Self-regulation is no option**

Another 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 simplified 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 the political right and among others the brilliant libertarian philosopher Robert Nozick. It also found its way into the left. Karl Marx was an exceptional historian, but he was less successful as a prescriber of recipes as he imagined his egalitarian society of dreams to be implemented by scientifically reasoning men. The leading left-leaning political philosopher of the twentieth century, John Rawls, likewise based his impressive Social Justice Theory on a reasoning Rational Man. The idea of The Rational Man partly misled political and economic decision-makers of the twentieth century.



Fewer and fewer in Europe 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<sup>5</sup> and the British Prime Minister David Cameron have 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.

The change in attitudes in Europe does not mean that the battle against the self-regulators has been won. The candidates supported by Wall Street managed to keep the majority in House of Representatives also after the latest election, even if they lost the popular vote, thereby ensuring a continuation of ‘the regulatory capture’. (Chapter VI: 3)

### **No global government**

Some dream about a global government. The distrust in the way leaders handle the global economy should, however, not be read as a support for 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 World Society and a global market economy, but few are longing for a World Community. 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 thus have a central role in creating social conditions in line with the values and the cultural traditions of each country. (Chapter VI: 4)

### **World Market Governance**

In Chapter VII I introduce an alternative way of approaching the governance issue. The purpose is to shape a fitness environment for the global market economy that creates a better control at the same time as the nation-states are strengthened. The argument is that we are seeing the emergence of the global market economy as an independent fundamental societal system with substantial power. The market economy as a concept has been a winner on a global scale, and this development has together with the globalisation of the financial markets, the IT revolution and the aspirations of the populations in the developing countries been

---

<sup>5</sup> Sarkozy, 2010

driving the development of an increasingly global market economy. The emerging global market economy has a similar justification to the nation-states. It is also a justified societal system 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 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. The global market economy is gradually becoming more independent of the nation-states and ought, according to the reasoning in this thesis, to be regarded as an inter-linked, but partly separate societal system that needs its own dedicated governance.

Many have called for proposals, but few, if any have engaged in a discussion on what more precisely that needs to be done and how to achieve it. Researchers in international regulations have shown how imperative it is that there is extensive institutional supply that ensures proper due process and transparency supported by a broad and sustained demand to achieve regulations in the common interest. I will discuss different principles for how such governance of the market economy – I call it World Market Governance (WMG) – could be structured and how it could come about. (Chapter XI). The ideas presented should be seen as an input into an urgently needed global conversation

## Objectives

FA Hayek in 1944 called upon “an international political authority which, without power to direct the different people what they must do, must be able to restrain them from action which will damage others. The powers which must dissolve on an international authority are not the new powers assumed by the states in recent times, but that minimum of powers of the ultra-liberal ‘laissez-faire’ state.”<sup>6</sup> For that purpose Hayek proposed a federation in which the Rule of Law was the centrepiece.

As we want to strengthen the nation-states and enable them to form social and cultural conditions in line with local and national preferences there are good reasons to let us be guided by the agenda of the market liberals and to define the objectives of the World Market Governance in line with the Hayek vision of an ultra-liberal global federation. The focus on the roles of states has changed slightly since Hayek developed his vision, especially when it comes to the necessity to take a joint responsibility for the global ecosystem and the objectives he had in mind have to be adjusted to that new reality. (Chapter VIII)

World Market Governance would following this reasoning have the following objectives:

- Regulation of the financial markets. The financial markets are global and the regulations invite regulatory arbitrage if they differ in scope and content. One

---

<sup>6</sup> Hayek, 1944, p 238

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.

- Establishing and enforcing laws of contract. Contracts do not only have to be harmonized, they also need to be possible to enforce.
- Preventing overt coercion of individuals by others. Fraud and undue exploitation of ignorance must be possible to pursue.
- Rules for acquisition and sales of assets. More and more companies and investors are active cross borders.
- A common foundation for the exploitation of natural resources. The countries in demand of commodities are often not the once with the resources. Common rules are necessary to avoid unfair conditions.
- Harmonized competition rules and regulation of unavoidable monopolies. A level playing-field for companies and other market actors with as far as possible equal and predictable rules is important. The US and the EU already have different competition rules and, above all, they implement them in different ways. China is now about to set up a third similar competition authority that may come to another set of conclusions, making the life of international companies even more difficult.
- Recognition of Intellectual Property Rights. Harmonization work is under way, but there are many areas where the rules differ, and, specifically, patents and other protective measures that are recognized by one country are not automatically recognized by other countries.
- Free and fair trade. Free trade is the ultimate goal and multilateral trade agreements that balance the interests of different countries the fairest way to reach it.
- Basic labour and migration conditions. Fair markets demand that basic legal conditions are harmonized, and that in particular the access to labour and the basic labour conditions are agreed.
- Stable currency relations and global money supply. Countries need to cooperate within a common framework to control money supply, create stable currency relations and solve national default situations.
- Agreed ways of internalizing "externalities", such as environmental impacts, into the market economy system. We have a joint responsibility for the world we are living in and have to address environmental and health challenges and future scarcity of commodities together. The most efficient way to take externalities such as pollution of air, water and soil, and other environmental issues such as climate change and deforestation into account is to ensure that the effects are internalized into the global market economy in a way that does not cause unfair conditions.
- 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 fair domiciliation of companies and citizens for taxation is one condition that is

important to avoid some of the regulatory arbitrage that undermines the finances of nation-states.

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.

### **Legitimacy**

I claim in Chapter X that a minimum of shared values is important for the legitimacy of the governance of the global market economy system.

But it is not enough to ensure a value-based proper due process in the legislative process to achieve regulations in the common interest. A new approach must start from a narrative shared by most people. It has to recognize the reality as it is perceived by most people, the despair many feel in front of unemployment, hardship and lost hopes. It must be open-ended, positive and tuned to the future.

The identified problems to be solved must include a demonstration effect, be felt to be relevant to people, expressed in a transparent way and based on secured evidence. It is not that we don't know enough to do anything and that there is no shared understanding of the challenges. We have sufficient knowledge, and we should act on the knowledge we already have.

Evidence is the first cornerstone in a decision-structure. The next is the Public Information Space, to use the terminology of Will Hutton. The latest years we have seen an explosion of social networking on the internet. Phenomena such as Face book, Twitter and LinkedIn have come to be named social media, the reason being that they not only network people, they also spread knowledge, initiate debates and create opinions. The strength of the social media is that they in a very short time can mobilize a considerable opinion; the weakness is the overflow of information. Journalistic media are needed to help all of us to identify the most important developments. Better evidence, public awareness rising are key to the decision-making, but there is one remaining question, and that is how a governance structure can come about that can decide upon rules and regulations that are binding for everyone and that are enforced. It is a key issue in the search of a solution. The crucial implementation will have to be followed by monitoring and enforcement. The evidence gathered for evaluations will make the governance a continuous process. (Chapter X)

### **The role of the functional global network systems**

Miles Kahler, Professor of International Relations, and David Lake, Professor of Political Science are recognizing three modes of global governance – networks, hierarchy and supranationalism.

The first that is dominating the present situation is the development of *global networks*. A trend is that functional societies are expanding their territorial reach, even are becoming global. Universities have for e.g. in a cumbersome, but basically successful dialogue, the so called 'Bologna process, agreed upon how academic examines, degrees and titles are to be

harmonized and made compatible. Medical experts are agreeing on best practices and they share valuable insights and data. In field after field actors and experts meet to discuss how to develop cooperation and learn from one another. Don Tapscott has made an interesting survey of such emerged organized networks, that he calls *Global Solution Networks*. He has found an impressive and rapidly growing community. The global networks are of different kinds and have taken on different roles, a few even a decision role. The most important of those are ICANN that decides upon the internet addresses. The global governance such networks develop is showing some common characteristics: there are iterative comparisons in the cognition process, the complex networks are self-organized, and they develop intensive dialogues. This is a generally positive development as long as there is no conflict between the interests of the actors within the functional community and the common interest.

Other networks, often NGO's, have taken on the role of enlighteners, such as the think-tank types and most environmental networks and they reach out to the public. They play an important role in the public awareness rising

Kahler and Lake are including trans-governmental networks in this form of governance. Those networks often have an important informal role that is hard to replace, but the track record is not only positive. Kahler and Lake note that the Intergovernmental Organizations (the IGOs) that were created after WWII often were substitutes for a form of networked governance that was viewed as a bastion of unaccountable power and uncertain membership. However, networked regulatory governance has come to increase as Bretton Woods broke down and globalization has increased. The governance structure often includes public-private networks or purely private networks with substantial regulatory power.

The Law Professor Kenneth Abbott and the political scientist Duncan Sindal have developed what they call a Governance Triangle to describe how the total networked governance structure looks like and has evolved. They put the states in one corner, the firms in a second and the NGO's in a third. The regulatory process involves many stages on which the nodes have different influence. Abbott and Sindal use the acronym ANIME for the process – Agenda-setting, Negotiation of Standards, Implementation, Monitoring and Enforcement and they show how complex the development by networks of the regulatory frameworks can be (Chapter XI, sect 2)

### **The legislator**

Modern democratic and radical republican theorists alike have good reasons to critically examine the guardianship model that has been increasingly adopted when it comes to the governance of the financial markets. Guardianship has an important place in the governance, but has to be anchored in an election or selection process that creates legitimacy. The republican model can, if applied to the legislation process create such legitimacy. Following this reasoning I suggest two chambers in the legislature, one that reflects the role of the countries in the global market economy and that is the final decision-maker, and one that ensures a public scrutiny and thereby offers the checks and balances that the process needs.

I call the first chamber that would be the final decision-maker for The Assembly. In this Assembly the recognized market economies could be represented in relation to their economic strength. The economic strength can be defined in several ways – GDP, share of the global trade and growth are possible factors to consider. The data could be historic but also include projections. That would initially give a strong voting power to the U.S., the EU and Japan - a voting power that rapidly will diminish as emerging economies will get an increased share of the votes. It is worth remembering that China is expected to surpass the U.S. as the largest economy in the world before the year 2020.

The majorities needed for decisions may vary and depend on where to draw the line between the power of the Assembly and national and regional sovereignty. Some decisions may be taken by 60 percent majority; others demand something close to unanimity. Absolute unanimity should always be avoided as it makes the process prisoner of any individual country.

There are several advantages with The Assembly as a forum for legislation. The obvious 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 advantage is the public character and the media scrutiny that supports regulations in the common interest. Even if people are not represented in a formal democratic way they can follow the debate and they can in countries where the governments rule with the consent of their people put pressure on their representatives to act in accordance with their interest when representing them in the Assembly. The Assembly should not be too large. It should be possible for people to identify the representative or representatives for their countries and how they are voting as that would increase both transparency and personal accountability.

To ensure transparency and checks and balances I propose a second chamber in the legislature, a Council. The Council could have similar powers to those of the British House of Lords; it could e.g. offer opinions on legislation and in case of difference in views influence or delay a decision by the Assembly. The purpose of the Council would be to ensure that the decision-making in the Assembly is evidence-based and transparent. The members of the Council should add personal knowledge and experience to the process. They can for example be seasoned economists and ecologists, business and union leaders, judges and lawyers. They could be appointed for a period of time by independent communities of NGOs, think-tanks and global networks and by international organisations such as the IMF, the WTO, the UNEP, the OECD and the FSB to ensure independence and create checks and balances. In this way the Council would represent both the interests of the financial elite and the interests of other stakeholders in the global market economy as they are channelled through global networks and NGO's. As the process is public the real influence of the Council can be expected to be larger than the formal one. (Chapter XI)

## **The Rule of Law**

A strong independent 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. (Chapter IX)

For execution the WMG can rely upon existing international organisations.

### **World Market Charter**

There is only one way to establish the WMG and that is through negotiations between the future members and through a treaty. As the treaty would have an extremely important role I have chosen to call it a charter. (Chapter XII).

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

The value-base and the objectives are proposed to be decided through the 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; the WMG 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. The purpose is on the contrary to strengthen the nation-states. The WMG 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.

Finally, it is worth repeating that a broad support from the citizens is imperative. For that to happen it would be highly commendable if the negotiations on a possible Charter, when they

are to start and even if they to their very nature have to be "top-down", were to be conducted in an open and transparent way and documented in working papers. That is a highly unusual procedure in international negotiations, but it would add to the legitimacy of any Charter. A public scrutiny is essential as it would increase the chances to gain public consent. One of the reasons why the US Constitution is held in such a high regard is the documented and public trace that the process left. A Charter negotiated behind closed doors and without public debate risks creating the impression that the interest of the 'many' is left out and that the Charter is all about distributing power among the 'few'. It is thus not just the content of a possible charter that would be important; it is also the way it would be created. A successful outcome requires skilful negotiators and a carefully thought-through process.

### **Practical examples**

I have in Chapter XIII developed some practical examples on how the WMG could work.

### **Broad and Sustained Demand**

The broad and sustained demand is together with an extensive institutional supply a precondition to avoid regulatory capture. Mattli and Woods have identified a number of important entrepreneurs that can help drive change in the common interest.

The first are the Nongovernmental Entrepreneurs of Regulatory Change. Non-Governmental Organisations (NGOs) who are engaged in global issues such as climate change and development aid are generally frustrated about the lack of decision power on the global level. NGO's have played a major role in driving human rights issues, and in creating public awareness around events, thereby contributing to the demonstration effects, but it must also be recognized that they when it comes to e.g. environmental issues and the functioning of the market economy often have lacked the resources for a sustainable campaign. What is needed for those who support change to win the fight in the public information space is to engage a broader part of the civil society in awareness raising and the creation of alliances and to use the new media in that effort.

Economists, political scientists and other researchers can also play a significant role in achieving that goal.

An important group are the Public Officials as Entrepreneurs for Regulatory Change. In this group I would like to include insightful politicians. My perception is that this group is much larger than generally perceived and that it is growing. National leaders are e.g. increasingly aware that their possibilities to fulfil their important social role are undermined by the fact that wealthy citizens and global companies are increasingly using the arbitrage possibilities to avoid paying taxes. Politicians know that they if they are to regain the sovereignty to decide in an independent way on the social conditions in their own countries need to create globally adopted legislations that diminishes the space for regulatory arbitrage.

Politicians are not the only public officials in favour of change. I have found a lot of support for my findings among leaders in the IGOs, in think-tanks and among governmental experts in Washington, Beijing, Paris and other places; the objection, or perhaps more correctly



question, which they table, is how the novel vision, which they embrace with some sympathy, can be turned into reality.

The third group that Mattli and Woods have identified are Private-Sector Entrepreneurs of Regulatory Change. Those are in the experience of Mattli and Woods the entrepreneurs for change with the best possibilities to mobilize the necessary perseverance and resources for a successful campaign.

Four categories of corporate entrepreneurs are identified.

1. Corporate consumers. They have a strong interest in addressing cartels and hindrances for competition that drives e.g. commodity prices.
2. Corporations at risk. A financial regulatory regime that creates predictability and gives priority to the main objectives of the banks, namely to give returns to savings and to finance business and sound investments, would be in the interest of most of the industrial actors.
3. Corporate newcomers. The business opportunities are enormous. The technological progress under way is fantastic and new technical solutions to the problems the world is facing are developed every day.
4. Corporate levellers of the playing-field. Industry is dependent on level playing fields and on predictability and it suffers when the global economy is moving from crisis to crisis.

A more difficult task is to gain support from the financial actors, who often thrive on uncertainty and risks. As long as the actors feel protected by the nation-states, being too important to be allowed to fail, and as long as any default has a negligible effect on the bankers' and traders' salaries and bonuses, while risk-taking can create fortunes, the actors will try to resist attempts to reduce the risk-level. However, not all of their concerns are illegitimate and the proposal I have made recognizes that this increasingly powerful group needs proper representation in the global governance structure.

To counter the existing climate of suspicion it is critical to involve China in all levels of discussions. The Chinese leaders need to take part in any reflections initiated by their peers among the global leaders; a way to commence could be to hammer out a possible agenda. Chinese researchers should be involved in the building of Global Systems Science and invited to workshops organized in cooperation with think-tanks, NGOs and the business community from different countries, including China.(Chapter XIV)

To conclude:

- The market economy is a winning concept. More and more economies are recognized market economies and fewer and fewer believe in planned economies.
- The market economies are becoming more and more intertwined and part of a global economy. The globalisation is driven by the aspirations of the populations in the emerging economies and enhanced by the development of a global information society

- The financial markets and their actors are increasingly global. No country can control them on its own.
- The market economy relates to partly different human features than the public order. We do not expect the market to offer equal outcome the way we do the public order.
- The present mainly inter-governmental governance of the global market economy is insufficient. It is reactive and many problems, not only economical, but also e.g. environmental, are left unsolved.
- The emergence of a global market economy is undermining the sovereignty of nation-states. The lack of coherent regulation enables financial actors, global companies and wealthy citizens to benefit from a regulatory arbitrage that makes it more and more difficult for nation-states to finance their public services.
- De-globalization is no answer and there is no new imperial order in the waiting.
- Self-regulation is no alternative. There is no Rational Man and no invisible hand steering the market to an acceptable outcome.
- There is no support for a global government. Social conditions and institutions are anchored in local cultures that people wish to defend.
- The solution is to see the global market economy as a partly separate societal system which needs effective, comprehensive and transparent governance. There are already existing global institutions such as WTO and IMF that regulate some of the market conditions and on which World Market Governance can be built.

## **II. THE GLOBAL MARKET ECONOMY – A WINNER GAINING GROUND**

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 governance of the global market economy 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.

## **The market economy – a winning model**

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.

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

**First.** The fall of the Berlin Wall. It 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. 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.

**Second.** 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).

**Third.** 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.

**Fourth.** The information technology revolution has created companies with global supply-chains and global markets. Those companies are pressing countries to synchronize regulations and conditions.

**Fifth.** The European project has harmonized the conditions within the EU and forced accession countries to rapidly adapt best practice.

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 is increasingly winning the day.

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.

The failure of the socialist alternatives is above all a failure for systems that have tried to plan the economic development from the top. The Western market economy model is in contrast to the alternatives a bottom-up system based on the power of division of labour in which the prices of goods and services are determined in a free price system set by supply and demand and in accordance with generally agreed rules and conditions. This model in itself is found to be attractive as it enables people to freely pursue their dreams, but it is not as simple as that. The global support for the market economy concept is with conditions. We humans seem in general to be prepared to be the means to other people's ends, if that is what it takes to meet our desires, but we are not embracing the market economy concept without a complementary order that ensures an acceptable outcome. I will argue that we do not expect that everyone will be as fortunate as those most successful, but that we expect our desires to be reasonably met and to be treated with sufficient respect and be given sufficient recognition. If those conditions are not met we express our resentment, we revolt and we strike.

That Russia and China have embraced the market economy system has been a major victory for the concept. The Chinese economy has of late been the foremost example of a market economy with an outstanding growth. But it has also shown an inability to address 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. Many are using the word "socialism" to describe a planned economy of the Marxist-Leninist type, but the Chinese Communist Party is now using the word in another way. Socialism is in China now described as an order in which the Party is in control of four pillars of the public order: the State and the Defence Forces, the appointments of officials (including judges and leading executives in state-controlled companies), and the flow of information.<sup>7</sup> The Chinese under the leadership of Deng Xiao Ping thirty years ago successively liberated the entrepreneurs and let the market economy grow organically in response to a disappointing development during several decades under the planned economy regime, but ensured at the same time that some of the benefits of the new order were directly captured by the State and the Party, mainly through ownership. The old school communists tried, after the events at Tiananmen Square 1989, to turn the clock backwards and reinstall top-down control of the economic development, with the predictable result that the economic growth stagnated. After a new intervention by Deng Xiao Ping 1992 the entrepreneurs were once more heralded and allowed to create "bottom-up" and since then the Chinese economy has been growing at a staggering speed. It is misleading to describe the present market economy in China as a socialist market economy in the sense that the term has been used earlier. China has a market economy that has many of the same characteristics as the Western countries.

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

---

<sup>7</sup> The central role of The Communist Party is described by Richard Mc Gregor, 2010.

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. Bo Rothstein<sup>8</sup> 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.

In that perspective I disagree with the political scientist Peter Hall and the economist David Soskice who see two successful main varieties of capitalism, the Anglo-Sachsen liberal market economy, and the coordinated market economy combined with a welfare state, a type of capitalism that is to be found in most of Northern and Continental Europe.<sup>9</sup> What they see is to my mind two different types of successful marriages between capitalism and the public order, not different types of capitalism. The Hall-Soskice definition has included aspects that are part of the public sphere of the nation-states and relate to institutions and public activities that are anchored in social and cultural values. The nation-states have, besides offering oversight of the civil society, the possibility to redistribute wealth that the market economy creates and use those resources to offer all citizens public services such as education, health care and pensions. To which degree the states do that is a domestic issue and does not to my mind make the market economies as such different. There are obviously different views on how active the state should be in the Western world but the way the markets work is very similar.

### **Emerging global markets**

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 1930's, 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.<sup>10</sup> 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 per cent 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.

---

<sup>8</sup> See e.g. Lindvall-Rothstein, 2010

<sup>9</sup> vgl. Hall and Soskice, 2001. Mentioned, but not discussed in Dahlsten, 2010

<sup>10</sup> vgl IMF history on [www.imf.org](http://www.imf.org).

The internal and protectionist focus has successively given way to a more open attitude in which 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 globalisation 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. It is, however, not a straightforward development. For example: The nineteenth century globalization created a division of labour between the European countries and South America. South America exported cotton, beef meat and the like to Europe that turned the commodities into industrial products. South America never developed the institutions that are a pre-condition for industrialization, something they were to suffer from during the main part of the twentieth century. With the emigration from Europe to the US, Canada and Australia followed another type of relationship. The emigrants brought with them the knowledge on how to build institutions and factories, which contributed to a fast industrialization of these countries.<sup>11</sup>

The catch-up processes have historically been win-win situations. Even if there are many winners also now, when China and India are catching-up, there are 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.

The most common answer to that question is that people have worried unnecessarily about such a scenario since the Japanese started to recover after World War II. Many believed at the time that the Japanese would overtake and out-compete American and European industry. But while some industries had to close down in face of the Japanese competition, others flourished as Japan increased its demand for Western products. The end result was that the wages in Japan reached European levels and after a while the Japanese were facing the same problem as the US and Europe, namely how to address competition from other countries that were trying to catch up. As a consequence of the unforeseen difficulties Japan faced a financial crisis fifteen years ago. It was read as an effect of a loss of export competitiveness due to an increased domestic cost-level and the emergence of new low-cost alternatives. A real-estate bubble also contributed. The general remedy prescribed to Japan by most actors –after interest rates were reduced to zero - was to increase domestic demand and to reduce the level of savings in the economy. The problem has been that the Japanese population has not complied. Some claim that it is a cultural issue, some a slow recovery of the banks and others that it is

---

<sup>11</sup> vgl. Rodrik, 2011, p 138-142

due to the lack of pension and health systems covering all citizens; it may be a combination. The result regardless of the root cause is that the Japanese economy has recovered very slowly; a positive late development, however, being that it has been less affected by the latest global crisis than other countries.<sup>12</sup>

One of the challengers that brought Japan to its knees was South Korea. Its competitiveness led to the closing down of both Japanese and Western industries, such as shipyards. The negative effect on employment in Europe and the US was, however, balanced by the increasing demand for other products and services. The Koreans are now starting to worry, almost as much as the Americans, the Europeans and the Japanese, about the effect on their economy of the two latest entrants on the global scene, China and India.

A reason why it could be different this time is the sheer scale of these countries' potential. Their populations 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 speed. What is happening is that information technology permits 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 per cent 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 have 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.

---

<sup>12</sup> Until hit by a tsunami in March 2011 with unknown consequences when this is written

Companies are increasingly globalised. 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 loser 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 and bodies, such as the European Union, to enlarge the space for creativity and to support innovation.

The globalisation 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 2010 increasing its export by 31.3 per cent and its imports by 38.7 per cent<sup>13</sup>. Of the export approximately 55 per cent were produced by companies with foreign owners. China has become the first or second trading partner to most developed countries.

Anti-globalization proponents are sometimes claiming that the migration and global trade is nothing new and, besides, that the population in the Third World is only marginally integrated. This all true, but it is also a fact that the integration of production and markets in complicated supply chains never has been anywhere close to where we are today and that the countries that take active part in the global integrated markets represent more than 90 per cent of the global GDP.

### **III. THE PUBLIC ORDER AND GLOBALIZATION**

---

<sup>13</sup> Xinhua, China Daily 7 April 2011.



## 1. SOCIAL SYSTEMS AND THE WORLD SOCIETY

I have already used the terms social system, societal system and society quite a lot. But what do the terms represent? That is a question that has divided sociologists, i.e. scientists who are dealing with the theory of social systems and society at least for a hundred years, if not more. The confusion is definitely not reduced if you add the different ways the terms are used by political scientists and political philosophers.

### Parsons

A sociologist that tried to bring some order to the conceptual debate was the American Talcott Parsons. He was trained in Germany, spent some time at London School of Economics, but ended up in the U.S. Some claim that he is the sociologist that brought the rich heritage of European sociology represented by e.g. Max Weber to the U.S., others claim that he was a conservative stuck in the idea of the U.S.' supremacy, seeing the U.S. as somewhat of an outpost in modernity. Although he seems to have few recognized followers, most sociologists, at least those interested in theoretical issues, have found it both important and relevant to define themselves in relation to his theories. The conclusion is that he is worth listening to.

This is how he defined a social system: It "consist in a plurality of individual *actors* interacting with each others in a situation in which has at least a *physical* or environmental aspect, actors who are *motivated* in terms of a tendency to the 'optimization of gratification' and whose relation to their *institutions* is defined and mediated in terms of a system of *culturally* structured and shared symbols"<sup>14</sup>(my italic).

With 'actors' Parsons means the point of reference, which is the 'ego', and the individual actor, which is 'alter'. He recognizes that actors can know, feel and judge things. When reflecting upon his claim, we can benefit from contemporary research, not easily available to him at the time (early 1950's). I will now and then come back to those present findings around human nature. For now it is enough to notice that Parsons 'knowing' seems to be possible to read into what is now understood as conscious cognition processes, his 'feeling' can be seen as the emotions stirred by the subconscious cognition processes and evaluations, while 'judgement' can be seen as the ultimate outcome of those processes, regardless of the involvement of conscious and subconscious selves. As the purpose here is not aimed at discussing the foundations of the Parsons' sociology it is enough to notice that his perception of what the actors do when reasoning more or less rationally is not far from our present understanding.

Parsons' most famous example of a simple social system is the relation of a doctor with his patients.<sup>15</sup> The patients are in Parsons' example members of a 'society'. In this society the norm is to be healthy and productive. Sick patients are thus dysfunctional. The role of the

---

<sup>14</sup> Parsons, 1991, p 5,6

<sup>15</sup> vgl. Parsons, 1991, p 428 ff

doctor is to bring back patients to functionality and in that sense he has a pivotal societal role. He has to analyze the reasons for the dysfunctionality. It could be a purely *physical* reason, a virus or an accident. Such aspects affect the social system, i.e. the system that includes the doctor and his patients. But the reasons for the illness could also be *motivational*; the patient may have required the illness as a negative response to the conditions of his participation in the 'society'. *Values* are essential in Parsons' definition of a social system. He writes about the position of the doctor: "The 'ideology' of the profession lays great emphasis on the obligation of the physician to put 'the welfare of the patient' above his personal interests and regards 'commercialism' as the most serious and insidious evil with which it has to contend"<sup>16</sup> Parsons want with this example show that not all social systems in a capitalistic society are focused on 'egoistic rationality' and that there is space in existing social systems for other altruistic values based on a cultural heritage with Roman and Christian roots. I will later come back to the discussion around values.

A social system can thus, in the mind of Parsons, be something as simple as the relations between a doctor and his patients. What makes it different from the perspective of a personality acting with other individuals is the functionality and the structure involved. Parsons' definition mentions institutionalization, and when it develops, it makes the social system more stable and durable. As social systems advances they can develop into societies. It is in Parsons' definition the persistence over the life span of a normal individual and the socialization of coming generations that makes a social system or a weave of social systems, into a *society*. Such a society does not have to be independent of other societies in time and space, but has to have the structural and functional fundamentals of an independently subsisting system, and that includes value-based 'patterns'. Parsons claims that the idea of a social contract between a ruler and the citizens as proposed by many philosophers would be void without a shared value base, normative 'patterns'. Those patterns legitimize coercion in order to uphold the society.

Parsons theory is, at least partially, supported by the findings of socio-economic researchers. The Nobel Laureate Elinor Ostrom has studied successful self-organized local, mainly functional communities and identified "design principles" of stable local common pool resource management. Ostrom and her many co-researchers have developed a comprehensive "Social-Ecological Systems (SES) framework", that has inspired many that are studying collective self-governance.

The SES framework has come to include the following "design principles"<sup>17</sup>

1. Clearly defined boundaries (effective exclusion of external un-entitled parties);
2. Rules regarding the appropriation and provision of common resources that are adapted to local conditions;
3. Collective-choice arrangements that allow most resource appropriators to participate in the decision-making process;

---

<sup>16</sup> Parsons, 1991, p 435

<sup>17</sup> vgl. Poteete, Janssen, and Ostrom, 2010

4. Effective monitoring by monitors who are part of or accountable to the appropriators;
5. A scale of graduated sanctions for resource appropriators who violate community rules;
6. Mechanisms of conflict resolution that are cheap and of easy access;
7. Self-determination of the community recognized by higher-level authorities;
8. In the case of larger common-pool resources, organization in the form of multiple layers of nested enterprises, with small local CPRs at the base level;
9. Effective communication;
10. Internal trust and reciprocity;
11. The nature of the resource system as such.

There are strong community elements in those self-governing local systems. The role of internal trust and reciprocity responds to a Parsonsian shared value-base. The rules for appropriation and collective-choice arrangements may also be seen by a follower to Parsons as a system of shared symbols and by followers of Luhmann as success media. Furthermore, there are physical and environmental aspects integrated in the system. Finally, the actors' relation to the institutions is defined, as well as to monitors and higher-level authorities. In short Lin Ostrom's findings seem to be in line with Parsons' definition of a social system, if the role of communication is added. In fact, if the system has a perseverance that stretches over a life-time it may even fulfil the criteria of a Parsons' society.

But her findings neither support nor undermine the position of Parsons' critics. Ostrom has studied successful self-governed communities that have fulfilled a certain well-defined function and in which there is a shared interest and mutual trust. Modern American sociologists, such as Robert Putnam, have noted that there is a limit to this type of community building. We can "bond" only to a limited group and in the best of case "bridge" to other groups. The findings of Ostrom cannot be generalized to a situation in which there are no shared interests and where the actors, while sharing some values, may disagree on others in a way that undermines mutual trust. As we move away from the local perspective to national and global arenas we also see that the development of communities with shared values becomes less likely. A common criticism from European sociologists is that Parsons underestimates the conflict of interests that derive from the different positions of people in the capitalistic societies and therefore the need for institutions and coercive powers for conflict-solving.

## Luhmann

One of Parsons' critics is the German sociologist Niklas Luhmann who recently has challenged traditional sociology in a 1200-page massive summary of his life's findings: "Die Gesellschaft der Gesellschaft". The Society of Society.<sup>18</sup>

His main critique is that Parsons conflates what German sociologists are calling *Gemeinschaft* with *Gesellschaft*. *Gemeinschaft* stands for community, *Gesellschaft* for society. It is the latter concept for which Luhmann has developed an increasingly enthusiastic group of followers, integrating his thinking in what some of them call Modern Systems Theory.

Luhmann' is first focusing on the emergence and development of social systems. He borrows the term *autopoiesis* from cognitive biologists to describe how a society creates itself and its environment through self-referentiality. A society is not, as proposed by Parsons and others. an assembling of individuals with shared values and interests, he claims. The fundamental element of a society is communication. The society is not inside individuals, but between them. Communication is really the only social activity, he argues, and it is manifested through *disseminating* media, such as emails, speeches etc, and through *success* media, such as money in the monetary system, grades in the school systems etc. The meaning of the self-description that follows any evolving social system is polycontextural and its interpretation depends on the observer and his position. The social systems are not static; they evolve with the communication and as their strategic positions are changed due to technological or other developments.

Luhmann thus sees communication as a foundational element in the creation of a society. There are three contingent selections, namely information (something must be 'chosen' as a piece of information at the expense of what is not chosen), utterance (i.e. this information is uttered in a specific matter and not another) and understanding (i.e. it is understood in one way and not another). The receiver of information may reject or accept it (which again demands information, utterance, and understanding). By doing that he contributes to an exchange of communications that contributes to the self-referentiality process.<sup>19</sup>

Just as many other modern sociologists Luhmann see a tendency to more differentiation. The development is not linear and sometimes complex structures of social systems have broken down. The reason is that they interfere with one another and a disturbance in one of them can destabilize a whole structure. In its elementary form, he claims, society is segmented. There is a functional uniformity of its parts - the meaning, the value and usefulness. But with increasing differentiation societies become stratified. People start to belong to class, estate, or caste. Trade relationships start to evolve and centre and periphery is developed and in the centre you see the development of *functional* social systems, an economic society, a political society, an educational society, a military society etc. Each society has its own tasks, but they all employ communication. With greater differentiation there is more communication, and with more communication the larger the societies become, Luhmann reflects. It is futile to look for a meaning in this development, he continues. Communication is followed by

---

<sup>18</sup> vgl. summary in English by Lee, 2000

<sup>19</sup> vgl. Stetter, 2007, p 3

evolution and differentiation through self-referentiality. The way the temporal and functional dimensions are influencing the process is not preset or predictable.

### **The theories on world society, world polity and world systems**

Luhmann claims that the only way to develop social theory is to start from the assumption that we all operate within a *world society* – a society that emerged some five hundred years ago as contact was established between the Eastern and Western hemisphere and the territorial barriers for communication disappeared. But world society is to Luhmann not the amalgam of established but increasingly interdependent societies with territorial boundaries and common rules and values. For him the world society is above all a wide array of functionally differentiated systems that include not just politics and economics, but also science, health, law, education and the like. They are “autopoetic” self-producing systems developing their own structural logic. Luhmann does not see conflicts as an abnormal feature in the world society or common values as a necessity to prevent them, but he is according to his critics underplaying the reasons for conflicts.<sup>20</sup>

The so called Stanford School has developed another theory called the *world polity* approach. They focus on how specific cultural models reproduce themselves in different settings. They see powerful global ‘isomorphic’ processes behind the expansion of the ‘state model’ as the main political unit in world politics. The reproduction of the states on a global scale cannot be understood from national perspectives but from the perspective of the ‘isomorphic qualities’ of the model. The same is true for the University model, the League model in sports etc. The Stanford understanding comes close to English School that claims that there are<sup>21</sup> powerful worldwide models about how humans should organize themselves. English school theorists are also interested in how states as well as individuals are constrained by the existence of common rules and values within an international society. Luhmann has criticized those theorists for placing the international rules and values as external factors to the societal systems.<sup>22</sup>

A *world systems* theory developed by Immanuel Wallerstein focuses on the fragmentation of the world society driving huge economic differences between regions. The theory plays down the territorial dimension and the role of states and focuses on the role of the economy. In a way the theory explains the outcome of “un-checked capitalism” that I will discuss later.

### **Community or society**

The German society-community approach so eloquently developed by Luhmann is helpful in our analysis. In many cases societies have a community element but it can sometimes be quite limited. But it is also true that societies that do not have a community dimension have proven

---

<sup>20</sup> vgl. the Preface by Richard Little in Stetter (ed.), 2007

<sup>21</sup> vgl. Stetter, 2007, p 5. Theresa Wobbe has made a comprehensive overview of all those theories in “Welt Gesellschaft”. My German is, however, too limited to enable me to quote her.

<sup>22</sup> vgl. The Preface by Richard Little in Stetter (ed), 2007 p xii

to be less stable than societies with such a dimension. History has e.g. told us that states that are not nation-states, i.e. do not consist of individuals that have a shared national identity, are less likely to survive in the longer run. I will come back to how states that are not nation-states have been recently challenged. The break-up of Yugoslavia is one example, the split-up of Czechoslovakia another, the raised level of conflicts in Belgium and Spain a third and the Scottish referendum on independence a fourth.

A question that to my mind may define the level of integration between a society and a community is *why* we communicate and, maybe more importantly, why we accept or reject a communication. Evolutionary biologists would claim that the common interest that is driving us to accept to participate positively in many functional societies is our wish to survive i.e. to get food, shelter and care, to reproduce and to support those with whom we share genes.

Communities are driven by partly other human needs. The psychologists will highlight our desire to be recognized, to learn and to be loved. And the neuro-scientists may add that we create stereotypes to manage an increasingly complex environment and that we have a need to identify with people that are like us – two factors that increase the aptness to belong to defined groups. Those findings by life scientists, which I will come back to more in detail, also show how unlikely it is that any *world community* will ever develop. It is an important conclusion as we should realize that successful value-based societies without opt-outs are unlikely on a global scale. I will come back to this discussion when I denounce the possibility of the emergence of a stable global government based upon global democracy.

The distinction between *Gesellschaft* and *Gemeinschaft* becomes more and more apparent and relevant as we turn to a discussion on the global issues. There is a World Society, but a World Community is unlikely to develop.

### **The evolving world society, global networks and global governance**

The role of communication as the driver of societal change is increasingly recognized. Many researchers are often highlighting the iterative comparisons in the cognition process and the complexity of all the networks as well as the self-organizing element. The Nobel Prize Winner Amartya Sen sees the emergence of a softer form of “democratic” global governance. He is in his brilliant "The Idea of Justice" criticizing the "overpowering concentration on institutions (where behaviour is assumed to be appropriately compliant) rather than on the lives people are able to lead".<sup>23</sup> The process to create an overall stable societal system based on just institutions as proposed by the philosopher John Rawls and his many contemporary followers is according to Sen flawed in the sense that it cannot be expected that a consensus can develop that will withstand time. There is a plurality in reasoning that has to be recognized and that will defy any attempts to create forever just institutions.

Sen is instead arguing in favour of a "public reasoning" in which the focus is on comparative analysis, reasoned scrutiny, and on the social realization of justice rather than on the arrangement of institutions. "Any theory of justice has to give an important place to the role of institutions, so that the choice of institutions cannot but be a central element in any

---

<sup>23</sup> Sen, 2009, xi

plausible account of justice. However...we have to seek institutions that promote justice rather than treating the institutions as themselves manifestations of justice".<sup>24</sup> The idea of a "final" society with just and settled institutions is a false dream. Institutions have to evolve with the demands of the time and advance based on the same comparative scrutiny as in the public reasoning on policies, Sen claims.

Sen points out that social realization can take place in the civil society without the involvement of institutions. This is true for many of the relations he mentions such as those between men and women, parents and children. It is also true for many of the professional relations. Sen's idea of reasoned scrutiny and a global public discourse is a very helpful instrument for the spreading of "best practices" on a global scale, but it should also be noted that it in the case of the global market economy there are many policies and actions that have gained broad support in the public debate, but are not implemented.

Miles Kahler, Professor of International Relations, and David Lake, Professor of Political Science are recognizing three modes of global governance – networks, hierarchy and supranationalism.<sup>25</sup>

The first that is dominating the present situation is the development of *global networks*. A modern trend is that functional societies of the type Ostrom has studied are expanding their territorial reach, even are becoming global. Universities have for e.g. in a cumbersome, but basically successful dialogue, the so called "Bologna process", agreed upon how academic examines, degrees and titles are to be harmonized and made compatible. Medical experts are agreeing on best practices and they share valuable insights and data. In field after field actors and experts meet to discuss how to develop cooperation and learn from one another. Don Tapscott has made an interesting survey of such emerged organized networks, that he calls *Global Solution Networks*<sup>26</sup>. He has found an impressive and rapidly growing community. The global networks are of different kinds and have taken on different roles, a few even a decision role. The most important of those are ICANN that decides upon the internet addresses. The global governance such networks develop is showing some common characteristics: there are iterative comparisons in the cognition process, the complex networks are self-organized, and they develop intensive dialogues. They are generally benefitting from the advances made in information technologies and a common feature is that the end-result is a win-win situation for all the parties concerned. This is a generally positive development as long as there is no conflict between the interests of the actors within the functional community and the common interest.

Other networks, often NGOs, have taken on the role of enlighteners, such as the think-tank types and most environmental networks and they reach out to the public. They play an important role in the public awareness rising. Others are closed, such as the Bilderberg Group, and although the popular perception that they should be part of some "secret" global government of the elite is misguided, those perceptions in themselves motivate a careful calibration of their role.

---

<sup>24</sup> Sen, 2009, p 82

<sup>25</sup> vgl. Kahler and Lake, 2009

<sup>26</sup> vgl. Tapscott, 2012

Kahler and Lake are including transgovernmental networks in this form of governance.<sup>27</sup> Those networks often have an important informal role that is hard to replace, but the track record is not only positive. Kahler and Lake note that the Intergovernmental Organizations (the IGOs) that were created after WWII often were substitutes for a form of networked governance that was viewed as a bastion of unaccountable power and uncertain membership. However, networked regulatory governance has come to increase as Bretton Woods broke down (I will come back to the background) and globalization has increased. The governance structure often includes public-private networks or purely private networks with substantial regulatory power.

The Law Professor Kenneth Abbott and the political scientist Duncan Sindal have developed what they call a Governance Triangle to describe how the total networked governance structure looks like and has evolved.<sup>28</sup> They put the states in one corner, the firms in a second and the NGOs in a third. They show how the networked governance in all three forms and with varied participation of the three nodes has increased rapidly the last two decades, especially in forms driven by the private sector and the NGOs. Networked governance is thus increasingly involving two or three of the nodes. Abbott and Sindal have found that most Triangle institutions have been created because their founders have been frustrated with the state as regulator: not only by the failure of states and the IGOs to address perceived problems, but by the structural weaknesses that has seemed to prevent them from doing so.<sup>29</sup>

However, the states often have had an important less visible role. Sometimes they have initiated a functional standard or regulation by threatening the parties with legislation should they not abide, sometimes they have a crucial role in the negotiation phases, and sometimes they are indispensable in the monitoring and the enforcement. The regulatory process involves many stages on which the nodes have different influence. Abbott and Sindal use the acronym ANIME for the process – Agenda-setting, Negotiation of Standards, Implementation, Monitoring and Enforcement and they show how complex the development by networks of the regulatory frameworks can be.

Kahler and Lake also highlights *hierarchy* as a form of global governance. With that they imply the influence that a dominant state can have on dependent states. The pressure can take many forms. It can be a claim of extraterritorial power, it can be an “emulation or else” or a more accepted thought leadership. Kahler and Lake give many examples, such as the U.S. demand of access to financial data in different countries as part of its fight against terrorism and drug trade. It is not only the U.S. that has exercised a hierarchical role, Kahler and Lake note, so has the E.U. towards its neighbours and trading partners. I will later discuss the perception of an Imperial Order and claim that the decline of the U.S. power not automatically will implicate the rise of another Imperial Order. Empires are the exception in history, in which countries mostly have interacted in an anarchical or multi-polar way.

The third global governance form is in the terminology of Kahler and Lake the *supranational*. It is worth remembering that the IGOs – the IMF, the Gatt, and the World Bank -were created

---

<sup>27</sup> vgl. Kahler and Lake, 2009, p 248 ff

<sup>28</sup> vgl. Abbot and Sindal, 2009, p 44 ff

<sup>29</sup> vgl. Abbot and Sindal, 2009, p 87



at a low point in international economic integration. They were not a response to the need for international governance following upon an increased globalization, but a reaction to the pre-war experiences of the lack of proper governance. Many economic theorists have expected the supra-nationalism to develop as economic integration has continued to proceed in key areas. However, this is not what uniformly has happened. There has been clear progress made in trade with the development of the World Trade Organization, although it has been halted the last decade. But the power of the International Monetary Fund has declined following the break-down of Bretton Woods and Foreign Direct Investments (FDIs) are regulated through a weave of bilateral agreements following the break-down in the seventies of an old “imperial” order.<sup>30</sup>

## 2. THE ROLE OF THE NATION-STATE

### The rationale for the state

In many ways the World Society has evolved according to the predictions of Luhmann. Functional societies in the form of networks have expanded their roles and conflicts have been mostly solved by communication (in the Luhmann sense) between networks. The problem is the balance of power. Luhmann discusses power and sees it as a success media in the political system. But it does not exist only in that system. Power as a success media plays a role also in other systems and in the interaction between systems.

The political system, or the political order that it is sometimes called, has the mandate to impose rules on other societal systems and enforce obedience to those rules. Political scientists see a hierarchy of societal systems. What make the political system different from other societal systems are basically two elements. The first feature is the *coercive powers*. The political system can without risking retaliation use such powers in relation to other systems and on individuals in order to impose its will. The other special feature is that there is *no opt-out*. You may want to move to be part of another political system, but you cannot escape being part of at least one such system.

The capitalistic economic system was initially more or less unchecked by the political system. The consequences were that some workers were exploited, while others were left unemployed, a skewed distribution of income and wealth, the creation of monopolies, and a misuse of nature and its resources. When the political system started communicating restrictions and setting boundaries for the economic system the success media leading to the acceptance of this communication was the ability of the political system to exercise power over the economic system. A hierarchical chain in the power as a success media was established. The same relation has been established between the national public systems and national school systems, energy systems, law systems and the like. Those systems have that in common with the political and economic systems that there is no opt-out. They can use power as a success media to force pupils, customers, prisoners etc to accept their communication, but their power originates from the political system,

---

<sup>30</sup> vgl. Kahler and Lake, 2009, pp 243-245

There are other types of societal systems that have power as one of their success media, religious and sports affiliations e.g. They have rules that you have to follow and means to enforce them, but the difference is that there is an opt-out. You can leave the church or the football club. The power of those systems is not externally generated, it follows upon a generally accepted communication between the institutional hierarchy and the members, and the rules have evolved through self-referentiality.

The need for societal systems in a hierarchical supreme position does not follow automatically from Luhmann's sociology. It can therefore be worthwhile to reflect upon how some influential political philosophers have argued in favour of the need for a state with coercive powers over other societal systems.

The philosopher, who seems to have had more influence on the American Revolution than anyone else, John Locke, is together with the 20th century libertarian Robert Nozick probably the liberal philosopher who has offered the most consistent argument. Locke starts, following Hobbes, in an imagined "State of Nature" where men are acting without the presence of the authority of a political society, a nation-state. Responding to those who criticised his starting point he argues in the Second Treatise<sup>31</sup>:

"It is often asked, as though this were a mighty objection: "Where are there - where ever were there - any men in such a state of nature?" Here is an answer that may suffice in the meantime:

The world always did and always will have many men in the state of nature, because all monarchs and rulers of independent governments throughout the world are in that state. I include in this all who govern independent communities, whether or not they are in league with others; for the state of nature between men isn't ended just by their making a pact with one another. The only pact that ends the state of nature is one in which men agree together mutually to enter into one community and make one body politic.

The promises and bargains involved in bartering between two men on a desert island, or between a Swiss and an Indian in the woods of America, are binding on them even though they are perfectly in a state of nature in relation to one another; for truth and promise-keeping belongs to men as men, not as members of society - i.e. as a matter of natural law, not positive law.

To those who deny that anyone was ever in the state of nature, I oppose the authority of the judicious Hooker, who writes: The laws of nature bind men absolutely, just as men, even if they have no settled fellowship, no solemn agreement among themselves about what to do and what not to do. What naturally leads us to seek communion and fellowship with other people is the fact that on our own we haven't the means to provide ourselves with an adequate store of things that we need for the kind of life our nature desires, a life fit for the dignity of man. It

---

<sup>31</sup> vgl. Locke, 1967, 2<sup>nd</sup> Tr., §§ 14, 15. A more developed quoting of Locke in Dahlsten, 2010, pp 59-62.

was to make up for those defects and imperfections of the solitary life that men first united themselves in politic societies.

And I also affirm that all men are naturally in the state of nature, and remain so until they consent to make themselves members of some political society.”

Locke thus seems to have had a need to defend himself against any accusation of basing his reasoning on purely theoretical constructs. He perceived his men and their state of nature to be a ”naturalistic” starting point even if he underlined that the analysis that followed was based on ”reason”.

Property predates in Locke’s view the existence of government, and therefore society can be dedicated to the protection of property.

Locke was using those prerequisites to conclude the need of a state, and at this stage he was clearly reasoning and not trying to describe a ”naturalistic” state:

“If man in the state of nature be so free, as has been said; if he be absolute lord of his own person and possessions, equal to the greatest, and subject to no body, why will he part with his freedom? Why will he give up this empire, and subject himself to the dominion and control of any other power? To which it is obvious to answer, that though in the state of nature he hath such a right, yet the enjoyment of it is very uncertain, and constantly exposed to the invasion of others: for all being kings as much as he, every man his equal, and the greater part no strict observers of equity and justice, the enjoyment of the property he has in this state is very unsafe, very unsecure. This makes him willing to quit a condition, which, however free, is full of fears and continual dangers: and it is not without reason, that he seeks out, and is willing to join in society with others, who are already united, or have a mind to unite, for the mutual preservation of their lives, liberties and estates, which I call by the general name, property.”<sup>32</sup>

Locke saw the relationship between the state and its citizens in the form of a ”contract”. However, it is a misperception that Locke’s social contract demanded democracy. On the contrary, Locke felt that a legitimate contract could exist between citizens and monarchies or oligarchies, which did not prevent his ideas from heavily influencing especially the American Revolution. His notions of people’s rights and the role of civil government provided strong support for the intellectual movement of the revolution.

The libertarian philosopher Robert Nozick “followed in the footsteps of Locke. Accepting the Lockean rights as ‘natural rights’ and by reasoning step by step and excluding the alternatives Nozick ends up arguing in favour of an ultra-minimal state.”<sup>33</sup>

---

<sup>32</sup> Locke, 1967, 2<sup>nd</sup> Tr., §123,

<sup>33</sup> Dahlsten, 2010, p 62

What makes a state different from an association for mutual protection is in his mind that the state has a monopoly on the exercise of power and that its protection is universal in the sense that it covers all citizens.<sup>34</sup> Nozick continues by developing the role of the state so that it protects the State of Nature and the Natural Rights from where he started to build his philosophy.

“There are many question marks around the Lockean ‘State of Nature’, but his and Nozick’s arguments for the need of a state are selected here for two reasons. First, they show that one can argue in favour of the need of a state without claiming that the state has to be democratic.”<sup>35</sup> Second, that one part of the civic society, specifically the financial markets, could come to define the space for the authority of the state was nothing they reflected upon. The state was in their reasoning the ultimate authority.

### **Regulations in the common interest**

While most hierarchical relations have been stable between the political system and other systems that are central to people’s life, prosperity and health this has been far from true for the relationship between the political system and the economic system. Un-checked capitalism triggered the development of democracies and unions, and for a while they were able to balance the drawbacks of this un-checked capitalism. It was possible due to a shared territoriality. But at the time of the first globalization period a hundred years ago the balance shifted. International functional networks became more powerful than national political systems and un-checked capitalism returned. The order of things was restored after WWII and an uneasy marriage between the political system and the economy system once again developed. In the Western hemisphere the marriage has been called democratic capitalism or liberal democracy. It is that marriage that now, once again, is in trouble.

The power relation structures in the societies and between different societal systems is something that has interested political philosophers and political scientists especially. Social systems interfere with one another and they may have consequences that are detrimental to other systems. People need to be protected from possible harm to life, health and property, regardless whether the effects are brought about by individuals or societal functional systems. Sometimes there is no conflict between the interests of those involved in a functional society and those outside. But this ideal situation is seldom present, when it comes to the areas that are discussed in this thesis – the financial markets, competition rules, domiciliation of income, and protection of the environment.

The underpinning assumption in political philosophy and science is that there is something that can be called the common interest and that there is a risk that regulatory frameworks developed within a functional community will fall short of meeting this common interest. This is a normative claim, outside the Luhmann nomenclature. I will come back to a discussion on the minimal set of key values that are needed to define the common interest. At

---

<sup>34</sup> vgl. Nozick, 1974, chapter I :5

<sup>35</sup> Dahlsten, 2010, p 62

this stage it is sufficient to state that there is enough of a consensus among people to accept the existence of such a common interest, although this is a far way from claiming that we live in a World Community with generally shared values.

There is increasingly rich literature on this subject. The Professors of International Political Economy Ngaire Woods and Walter Mattli have made a helpful synthesis of the debate between the public interest school of regulation and the capture school, which I later will comment upon, and applied their conclusions on the present international order as it is under development.<sup>36</sup> They see two missing dimensions. They claim that there is a need to improve *the institutional supply* in the form of authority, proper due process, transparency and multiple access points but also to expand *the demand-side* from narrow and limited to broad and sustained if we want a process for global decision-making that will lead to regulations that are more in the common interest.

There are in the Mattli-Woods model four possible outcome of a regulatory regime depending upon the demand and the institutional supply

*Pure Capture Regulation.* This is the ‘classical’ case in which there is limited institutional supply (closed and exclusive functional forums, minimal transparency) and a narrow, limited demand. The narrower interests, the ‘haves’, steer the agenda-setting and the regulatory process without risking interference by any other group as there is a secrecy around the process. The ‘have-nots’ are often accepting this capture as their cost in most cases is small.

*De facto Capture Regulation.* This is the expected outcome when there is an extensive institutional supply with proper due process, multiple access points etc, but a narrow demand. Stark asymmetries in information, financial resources, and technical expertise create conditions conducive to regulatory capture even in an international context, which is offering extensive formal due process and privileges, thus privileging the ‘haves’ at the expense of the ‘have-nots’.

*Capture but with Concessions and Compromises.* This is a likely outcome if there is limited institutional supply but a broader sustained demand. For the latter to develop Mattli and Woods see the request for a demonstration effect, i.e. a diffusion of information about the social cost of the regulatory status quo via glaring inadequacies or failures as well as for those representing change to forge powerful and lasting alliances. It is not enough with broad demand; it also has to be sustained.

*Common Interest Regulation.* This is the hopeful outcome in an ideal situation when broad and sustained demand intersects with ample institutional supply.

### **The modern nation-state**

The modern state has a short history. The sovereignty-claiming state is a European invention following the Westphalia Treaty in 1648. The ruler of a state was granted the right to his territory and the right to decide the choice of religion and the law of the land. The idea of the nation-state, i.e. that the state is based upon a ”nation”, a culturally and socially cohesive unit,

---

<sup>36</sup> vgl. Mattli and Woods, 2009, p 15-17

is also relatively new. Empires, consisting of many nations, are common in history and the result of peace negotiations has frequently been that states have been allocated territories that are inconsistent with the perceived national identities. Such states are often unstable, constantly subject to internal and external challenges. Although there are discrepancies between nations and states, I will, somewhat incorrectly, sometimes use the word nation-state as a synonym to the state, the reason being that I want to avoid any confusion with the "states" within federations.

“Traditional political theory often makes a distinction between civil society and polity. ‘Civil society’ is everything from family and community life and the exercise of religious beliefs to the organisation of production and markets. The market economy is thus part of the civil society in this tradition. ‘Polity’ can be described as a public order which has the authority to regulate the relations between citizens (demos) living within its reach. The purpose of the polity is in the liberal tradition primarily to protect the citizens from harm to their health, life and property. The polity should, however, not dominate the citizens. The citizens are in the tradition granted civil rights, i.e. exemption from control in respect to their persons and properties.

The perception historically has been that the citizens can belong to only one polity. In ancient times that polity was often a city-state; today polity is mostly consisting of sovereign nation-states. The structure of polity has, however, continued to evolve; nation-states have joined federations, new regional and global political bodies with power such as the European Union and the World Trade Organization have been created. It is no longer obvious that citizens belong only to one polity. They are in practice belonging to a hierarchy of societal systems with different reaches and different objectives. One level, usually the nation-state- is more fundamental than the other levels as it has sovereignty and constitutional power and as it defines citizenship, but it is not always that simple. The situation is often more blurred in the case of federations, such as the United States. The constitutional power rests in the US in principle with the states, but they have given up some of that power, as well as the citizenship and the sovereignty to the federation.”<sup>37</sup>

“While global cooperation has increased it would, however, be a mistake to see the present situation as a new world order.”<sup>38</sup> Most institutions are inter-governmental or demand unanimity for decisions to be taken. In some cases powerful states have had their authority denoted through the granting of vetoes or special voting rights in line with the Westphalia thinking.<sup>39</sup>

I will, in this more principled discussion and for the sake of simplicity and clarity, regard the nation-state as the constitutional level. That level is defining the legislative and judiciary power of other political systems.<sup>40</sup> Such powers are in the case of cities and regions within a

---

<sup>37</sup> Dahlsten, 2010, p 56

<sup>38</sup> Dahlsten, 2010, p 63

<sup>39</sup> vgl. Held, 1995, p 97

<sup>40</sup> vgl. Dahlsten, 2010, p 57

nation-state given through law. International bodies, such as the European Union, which have both legislative and judicial powers and the World Trade Organisation that has judicial powers, have been assigned those powers through treaties.

Polity is as mentioned frequently defined as a public order which has the authority to regulate the relations between citizens living within its reach. The political scientist David Held notes<sup>41</sup> that a common claim is that the polity has territoriality, i.e. makes claims to territories within exact borders, a monopoly on coercive actions, an impersonal structure of power and some form of legitimacy. The political scientists John S Dryzek and Patrick Dunleavy offer a more elaborate definition of the state.<sup>42</sup> They separate coercive powers in two defining characteristics – the first is that the role of state is to reach collectively binding decisions that are obeyed by those living in the territory claimed by the state; the other is the monopoly of the legitimate use of physical force within the state territory. The state must according to Dryzek and Dunleavy also claim sovereignty, which in their definition is unconstrained power over all other institutions. This is a far-reaching claim that no longer seems to be true. States have in an irrevocable way given up much of the power over institutions to international bodies through treaties and to city and council administrations and the like through laws. What remains of the sovereignty is the constitutional power (only states can extend powers to other institutions), the territorial integrity and the right to offer citizenship.

The relation between the polity and the civil society has also become more blurred, if it ever has been clear. Dryzek and Dunleavy are noting that the state helps define a "public" realm, a part of social life different from the "private" sphere of concern only to the individuals or organizations involved. According to them, the public realm includes not only strictly governmental activities but all political activities aimed at influencing state institutions and changing or stabilizing how the society operates. This claim is following an important modern discussion within political science about how the decision-making within states actually works, the role of cultural and social diversity, "interest groups", the elite, the media, the "market" and other factors. There are many such links between the formal decision processes within the state and the society as a whole and they are important. However, what is concerning us here are processes leading to binding conditions, institutional or not, from which there is no opt-out for the individual.

### **The nation-state is not the only societal system with coercive powers**

The nation-state is thus no longer the only public order. The nation-states have more or less freely given legislative and judiciary powers to other levels that also have substantial power in relation to the individuals. While there are good reasons to build upon the philosophical heritage from e.g. Locke and Nozick and while Held, Dryzek, Dunleavy and many other political scientists have developed the theory around the state in a substantive way it is to my mind necessary to recognize this new reality and leave the idea of the one "polity" behind us. Building upon this reality and the theoretical heritage I will use the term Fundamental

---

<sup>41</sup> vgl. Held, 1995, p. 48-49

<sup>42</sup> vgl. Dryzek and Dunleavy, 2009, p 2-3

Societal System as a label of systems, which are part of the societal governance order. Keeping as much as possible of the definition of polity I have defined a Fundamental Societal System in the following way:

A Fundamental Societal System is an order that regulates the relations between individuals and that is

- central to the life, health and property of people
- on which the individual has no direct influence,
- which has no opt-out
- covers a certain territory
- has coercive powers, and
- has a recognized legitimacy

The definition is aligned with the definition of polity, but deviates slightly for reasons I wish to explain. The first is that I want to make the purpose of the fundamental societal systems somewhat more clear. Liberal philosophers who have defended the justification of a nation-state have claimed that it is "central to the life, health, liberty and property of the citizens"; the nation-state is needed especially to protect people from harm. What makes a fundamental societal system ultimately justified is thus to my mind its ability to help people to meet their needs.<sup>43</sup>

An important issue is to sort out the relative importance of the different needs, their interdependence and how they relate to the nation-states, the market economy and the civil society in general.

"Another characteristic of polity, in the quoted definition, is that it is a 'public order with authority', which means that the individual has little direct influence on the societal system; he may have indirect influence (voting rights etc.), but he cannot impose his personal will on the public order which in practice has an authority that is independent of him."<sup>44</sup>

The perception of one polity has had the implication that one obvious feature of a fundamental societal system seems to have been understated and that is that there is no opt-out. The opt-out criterion is important in a discussion around separate systems.<sup>45</sup>

"The territoriality can, as already noted, vary between the fundamental societal systems; the nation is one level, federations and unions another and the global level a third.

There are two aspects of polity that are left out in this definition of a fundamental societal system. The first is the existence of 'an impersonal structure of power', the reason being that a

---

<sup>43</sup> vgl. Dahlsten, 2010, p 57

<sup>44</sup> Dahlsten, 2010, p 58

<sup>45</sup> vgl. Dahlsten, 2010, p 59



societal system can have authority and exercise coercive actions outside the control of an individual without having an impersonal structure of power.

To be 'legitimate' a fundamental societal system needs a structure and governance that meets ethical standards. The liberal tradition frequently demands some form of public consent, e.g. a social contract, in order for the polity to have legitimacy"<sup>46</sup>. "The perception of legitimacy has changed over time and the way a societal system is governed, and its output from an ethical point of view has become increasingly important."<sup>47</sup> Legitimate governance is an issue of great importance.

With this definition of a fundamental societal system it is obvious that not only states are such systems but also the federal levels in e.g. the US and Germany, the European Union and many regional and city administrations. The line of reasoning, that I will pursue, leads to the conclusion that the global market economy has developed into another such system that has become more and more independent of the nation-states.

## **IV. A MARRIAGE IN TROUBLE**

The first wave of industrial capitalism was developed in the Western world in the late nineteenth century and it benefitted from the technological progress of the time – the steam machines, the railways, the electricity etc. New products and services were developed and they found new markets. The industrial revolution was full of promises, but the unchecked capitalism, on which it was based, also displayed some negative features. There were especially four shortcomings that became apparent:

- Exploitation of some workers, while others were left unemployed
- Unreasonably skewed distribution of wealth
- Tendencies to establish monopolies and block competition
- Exploitation of nature and natural resources

### **Democratic Capitalism -a marriage of convenience**

The drawbacks fuelled a popular reaction that inspired the development of the modern democracies and the creation of labour unions. The democratic nation-states developed "top-down" measures to address the problems of an un-regulated "bottom-up" capitalism. And there was real progress made in many nation-states. Health and environmental issues were addressed, labour conditions regulated and a more fair distribution of the production values initiated. But the development was early on affected by an increasing globalisation based on an unstable colonialism. Nation-states lost control of the development, followed by a financial

---

<sup>46</sup> Dahlsten, 2010,p 59

<sup>47</sup> Dahlsten, 2010,p 59

meltdown and the Great Depression. I will in a moment discuss this first “Return of Unchecked Capitalism”

The new world after the Second World War gave democracy and capitalism the chance to redeem themselves, this time inspired by a new generation of economists led by John Maynard Keynes, and driven to a considerable extent by the confrontation with the Stalinist empire. Financial markets were regulated; policies for full employment were introduced and Roosevelt’s New Deal showed the way towards a fairer allocation of resources. Protectionism slowly gave way to free trade, enabling more countries to benefit from the value creation that the market economy system enabled.

A fairly successful marriage between the capitalist system and democracy was formed, sometimes called “democratic capitalism”, sometimes “liberal democracy”. It is a marriage of convenience and it has never been an easy marriage. Capitalism and democracy are two completely different projects that only have the label “liberal” in common. They have also different philosophical backgrounds. Democracy and human rights are inspired by philosophers such as John Locke and Immanuel Kant, whose focus has been on social arrangements. Capitalism with Adam Smith and Marquis de Condorcet as somewhat of ‘fathers’ is on the other hand highlighting the role of continuous comparisons for the realisation of ideas and projects.

One should remember that the marriage between market liberalism and democracy is a recent achievement. The founders of the American Revolution did not recognize that they were building a democracy and while representation was at the heart of the constitution it was originally only men with properties that to a certain degree were represented. James Madison, whose influence on the US constitution was considerable, insisted that they were creating a republic, not a democracy. In *The Federalist* 10, published in 1787, he wrote that “democracies have ever been spectacles of turbulence and contention; have ever been found incompatible with personal security or the rights of property, and have in general been short in their lives as they have been violent in their deaths”.<sup>48</sup>

The fear of the rule of the ‘masses’ has been a recurrent theme in philosophical and political discourse that has never really disappeared. John Stuart Mill, who is seen as the most democratic and progressive of the nineteenth century liberals wrote 1859 darkly of ‘the tyranny of the majority’ and proposed weighted voting in order to restrict the power of the masses. Habermas is accusing the European politicians to take decisions behind closed doors and see this tendency as an expression of a political fear for the public scrutiny and debate that is a necessary part of a democratic process.<sup>49</sup>

The uneasy marriage between market liberalism and democracy that has developed over time is a marriage of market liberal rights, such as property rights, freedom of contract, and unrestricted private markets, protected by law and an independent judiciary, with civil and political rights and formal democratic procedures. The economist Dan Rodrik explains the

---

<sup>48</sup> Madison quoted by Dryzek and Dunleavy, 2009, p 21

<sup>49</sup> See Habermas, 2011

raison d'être: "The only countries that have managed to become rich under capitalism are those that have erected an extensive set of formal institutions that governs markets: tax systems that pay for public goods such as national defense and infrastructures, legal regimes that establish and protect property rights, courts that enforce contracts, police forces to sanction violators, bureaucrats who design and administer economic regulations, central banks that ensure monetary and financial stability, and so on."<sup>50</sup>

The marriage has taken many forms. I have already mentioned that political scientists often make a difference between the Anglo-Saxon version and the 'corporate' European, especially Nordic model. Neo-pluralists, elite theorists and Marxists highlight the influence of the business elite on the decision processes in the Anglo-Saxon liberal democracies, while the more classical pluralists see a balanced influence of different interests in the European welfare states. A post-Marxist sceptical take of the corporate model is that it is a means of disciplining labour, while the bargain necessarily is favouring business.<sup>51</sup> Some, like TM Marshall, highlight a development of rights in three steps as part of the road to a European welfare state: Legal and civil rights, political rights and effective economic and social rights.<sup>52</sup> Peter Flaschel and Sigrid Luchtenberg have in a recent book developed the theoretical foundations for social capitalism, which in their version is a concept very close to the Nordic Model.<sup>53</sup>

The discussion about Social Rights "led during the 20<sup>th</sup> century to the formulation of a more social set of value-based rights. John Rawls has been given most of the credit for the development of the philosophy of social human rights but many of his ideas had actually started to be adopted in European charters before he wrote his famous 'Social Justice'."<sup>54</sup> The UN Charter on Human Rights initiated by Eleanor Roosevelt after World War II also contained many rights that can be seen as social. Man has according to this thinking not only the right to expect the state to protect him and his property but also to provide him with the necessary conditions for a good life. "In the UN Universal Human Rights Declaration unanimously adopted by the 2005 UN World Summit, the following social human rights are asserted:

'Everyone has the right to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, housing, and medical care and necessary social services, and the right to security in the event of unemployment, sickness disability, widowhood, old age or other lack of livelihood in circumstances beyond his control.'

These rights are reflected in The Charter on Human Rights that has been adopted by the European Union and has been accepted by almost all members of the Union.<sup>55</sup>

---

<sup>50</sup> Rodrik, 2011, p 15,16

<sup>51</sup> vgl. Dryzek and Dunleavy, 2009, p 138

<sup>52</sup> vgl. Dryzek and Dunleavy, 2009, p 41-42

<sup>53</sup> See Flaschel and Luchtenberg, 2012

<sup>54</sup> Dahlsten, 2010, p 86

<sup>55</sup> The most notable exception is the UK. The reason, at least officially, to be found in special UK objections related to labour market conditions.

Formulated the UN way the social rights can be seen as a safety net available to everyone, but the level of the safety net is a contentious issue.”<sup>56</sup> Two types of critique are common. The first is the view that there should be an exact correspondence between the rights and correlated duties, and such correspondence is lacking in social rights. The other critique is the feasibility issue. There is a question if some of the rights are possible to realize at all, at least not everywhere.

The marriage between the market liberalism and democracy has gained support not only from democrats but also from some outspoken market liberals. Hayek wrote 1944: “There is no reason why not in a society that has reached the general level of wealth which ours has attained.... some minimum of food, shelter and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody...Nor is there any reason why the state should not assist the individuals in providing for those common hazards of life against which, because of their uncertainty, few individuals can make adequate provision. Where, as in the case of sickness and accident, neither the desire to avoid such calamities nor the efforts to overcome their consequences are as a rule weakened by the provision of assistance, where, in short, we deal with generally insurable risks, the case for the state helping to organize a comprehensive system of social insurance is very strong.” There may be disagreement about the details, Hayek notes, especially how to ensure competition, but there is no incompatibility with the preservation of individual freedom.<sup>57</sup> He expressed less certainty on how to handle the large-scale unemployment of the time, an unwillingness that was shared with many politicians and that paved the way for the totalitarian regimes of the thirties. I will come back to the lessons we can learn.

There has been a recurrent debate about the risk that the balance between market liberalism and democracy gets disturbed, especially the risk that the liberal democracies should turn into socialist states. What makes a state socialist? Hayek claims that it above all are the methods, i.e. the central planning of the economic activities and the public ownership of the production, that define the socialist state and he shows convincingly, and in this respect history has vindicated his views, that those conditions if fulfilled in all their consequences with necessity will lead to totalitarianism, a loss of individual freedom and a form of serfdom.

But the view of what a state can do and not do without ‘destroying’ the wealth creation of the competitive market system has varied over time and Hayek is himself a bit unclear about his position. On one hand, he argues that the dogmatic approach by the early twentieth century market liberal economists to the problems of the day paved the way for socialism and totalitarianism; on the other hand, he stretches the demand for a hands-off state much further than the methods he so vividly, and correctly, opposes.

One example: Hayek mentions that the fact that the central and local authorities in Germany as early as 1928 directly and indirectly controlled the use of 53 per cent of the national

---

<sup>56</sup> Dahlsten, 2010, p 86

<sup>57</sup> vgl. Hayek, 1944, p 125

income as evidence that they controlled almost the whole economic life of the nation.<sup>58</sup> He also mentions Sweden in a negative context as “a model country to which progressive eyes were directed”<sup>59</sup>, most likely because of the relatively high portion of the GDP that passes through the public system.

But is the percentage of GDP that passes through the public system really a measure of ‘socialism’? In the case of Germany in 1928 there was most probably a correlation, but that does not make it true at all times.

Rodrik notes: “Governments are bigger and stronger not in the world’s poorest economies but in its most advanced economies. The correlation between government size and per capita income is remarkably tight. Rich countries have better functioning markets and larger governments when compared to poor ones... Markets and states are complements, not substitutes, as simplistic economic accounts often have it”. Rodrik refers to a study that shows that “Governments had grown faster in those economies that were the most exposed to international markets. Some countries are naturally more sheltered from the forces of international competition, either because they are large or because they are distant from their major trading partners. This is exactly the case of the small government economies {investigated} (Japan, United States and Australia). Small economies close to their trading partners, by contrast, engage in much more trade and have larger public sectors (such as in Sweden and The Netherlands).”<sup>60</sup>

A comparison between countries shows that a major part of the difference in public expenses, in percentage of GDP, often relates to the role of women. Sweden has taken the view that women should have the same right as men to participate in the labor market. They should not be ‘locked in’ with their children or with their elderly parents. Therefore there is an elaborate system of paid parental leaves, nurseries and care of the elderly (often run by private companies). This is costly and is in Sweden paid in two ways: The high female participation in the market economy is leading to more hours worked per capita and year than in any other Western country and the other way is through somewhat higher taxes. The result is a society that in a huge international sociological study has been ranked as the most individualistic and pro-change country in the world.

The conclusion is that the marriage between democracy and the market economy not only has taken many forms but that several forms have been successful. This discussion goes to the heart of the question, whether there is any realism in a global society with a global democracy. In another language: Can we solve the problem with a growing territorial mismatch between the nation-states and the market economy by expanding the nation-states geographically, by building a ‘global state’? The answer by Hayek is no, and I share that view. As Hayek points out: “The belief in the community of aims and interests with fellow-men seems to presuppose a greater degree of similarity of outlook and thought than exists

---

<sup>58</sup> vgl. Hayek, 1944, p 64

<sup>59</sup> Hayek, 1944, p 3

<sup>60</sup> Rodrik, 2011, p 16

between us merely as human beings. If the other members of one's group cannot all be personally known, they must at least be of the same kind as those around us, think and talk in the same way and about the same kind of things, in order that we can identify ourselves with them. Collectivism on a world scale seems to be unthinkable – except in the service of a small ruling élite<sup>61</sup>

The point is that every country should have the right to develop its own social and cultural system without interference from anyone else and that whatever road it chooses this should not make it a less valued member of the global market community.

It is also dangerous to only adapt a Western perspective. There are many other forms of states and governance. The Russian President Boris Yeltsin was democratically elected, but was running the country through decrees that often violated both economic and political liberal rights. The Russian illiberal democracy stands in contrast to the liberal authoritarianism of General Pinochet in Chile, who implemented property rights, freedom of contracts and unrestricted private markets while vigorously suppressing civil and political rights.

All the types of co-existence of market liberalism and different forms of state governance that have developed over time are built upon one simple assumption: The state can create and steer the conditions for the markets within its territory. The marriage between market liberalism and the public order has thus been a marriage of convenience and of contrasts. A bottom-up, individualistic system has cohabited with a top-down, collectivistic system.

### **The Return of Un-Checked Capitalism**

The marriage has been through many minor predicaments and, in the early twentieth century, a severe calamity of an international scale that developed into a crisis of systems. The drawbacks of un-checked capitalism started to reappear in some Western countries, especially continental Europe, in the form of unemployment and inequality. The UK was the dominating power at the time, and did not listen to the complaints from continental Europe. Many view the First World War as part of this evolving systemic crisis. There was a Return of Unchecked Capitalism, not everywhere at the same time or in the same way, but where it cropped up, it eroded popular trust in the marriage and in both its partners, both the democratic system and the market economy.

Industrialization had been followed by an accelerated globalization and relocation of industries. This was a one-sided globalization; characterized by colonialism and exploitation of weaker countries by military means. Western industries wanted and gained access to raw materials and new markets.

The money involved increased rapidly as did the opportunities for fast rewards which made the financial elite demand liberal financial markets. As a consequence, the globalized

---

<sup>61</sup> Hayek, 1944, p 144

financial markets started to become flooded by speculative 'hot money' to use the language of the famous economist JM Keynes. A second consequence was that governments lost control of the flow of money.

There were early calls in many continental countries for protectionism and de-globalization in face of the rising unemployment; the responses by governments in the form of protectionism and other measures may even have deepened the crisis as it evolved into a Wall Street crash and the Great Depression. The American President Herbert Hoover followed another route, inaction, something he regretted later. The perception was that something good would come out of the crisis, that increased unemployment and hardship would teach people to work harder and live a more moral life.

The Great Depression and its aftermath came to challenge the legitimacy both of capitalism and democracy. The economist Peter F Drucker used 1939 the provocative language 'The End of the Economic man'<sup>62</sup> in his analysis of the crisis and the origins of totalitarianism. He saw the despair of the masses as the main reason for the breakdown of trust. While the politicians struggled to restore the economic and financial systems the masses experienced permanent unemployment, 'too old at forty', and economic sacrifices. The masses saw 'The Return of the Demons' that the liberal democracies had promised to root out. "The masses joined fascism not because they believe in its promises, which take the place of a positive creed, but because they do not believe in them"<sup>63</sup>, Drucker argues and continues: Mussolini himself "repeatedly boasted that fascism, when it came to power, had no positive policy, no program, and no system."<sup>64</sup> Drucker notes that not even the best-organised Nazi mass meetings showed any enthusiasm for the worship of the old Germanic gods, the Nordic perfect man, the corporate state composed of self-governing, autonomous 'estates' and the heroic family. What drew people to fascism were the refuting, fighting, and denying of all traditional ideas and ideologies, yes, of the very foundation of the social and political system. An additional factor that explains the success of fascism was that the experience of the nineteenth century, which attracted the emotional and sentimental attachment of the masses in Italy and Germany, was national unification, not the victory of the bourgeois, 'democratic' order, Drucker writes. Democracy was installed 'from the top' and not through revolution from below, which contributed to its collapse.

The fascists may have lacked credible programs, but their relative success, when taking over, should not be overlooked. They addressed the unemployment and gave everyone a role, a way of supporting himself and his family. Through Wehrwirtschaft the Nazis organised the German society as a military machine, where everyone had his place, with superior and subordinate 'officers. Non-economic incentives helped keeping people in line.

Hayek claims in his 'The Road to Serfdom'<sup>65</sup>, published 1944, that the socialist thinking that politicians had started to adopt after World War One paved the way for the fascists. While

---

<sup>62</sup> See Drucker, 1939

<sup>63</sup> Drucker, 1939, p 11

<sup>64</sup> Drucker, 1939, p 11-12

<sup>65</sup> See Hayek, 1944

Drucker highlights the despair of the masses as the root cause of the growth of the national socialist and fascist movements, Hayek sees the masses as followers “the docile and gullible, who have no strong convictions of their own but are prepared to accept a ready-made system of values if it is only drummed into their ears sufficiently loudly and frequently. It will be those whose vague and imperfectly formed ideas are easily swayed and whose passions and emotions are readily aroused who will thus swell the ranks of the totalitarian party.”<sup>66</sup>

The German state controlled almost all aspects of the economic life already before the national socialists came to power, Hayek suggests. Nationalisations had taken place and protectionist moves had been undertaken that had deepened the economic crisis at the same time as the ‘planned economy’ thinking was established and created a momentum for the fascists. “The problem is not why the Germans as such are vicious, which congenitally they are probably no more than other peoples, but to determine the circumstances which ... have made possible the progressive growth and the ultimate victory of a particular set of ideas...”<sup>67</sup>. “Hitler did not have to destroy democracy; he merely took advantage of the decay of democracy and at the critical moment obtained the support of many to whom, though they detested Hitler, he yet seemed the only man strong enough to get things done.”<sup>68</sup> “In this stage it is the general demand for quick and determined government action that is the dominating element in the situation, dissatisfaction with the slow and cumbersome course of democratic procedure.”<sup>69</sup>

But where Hayek saw an ideological uptake of socialist thinking, Drucker saw a rejection. “The intellectual elite which, before 1914, had been mesmerized by Marxism, deserted it almost entirely after 1918 and flocked to new leaders and to new thoughts. Max Weber in Germany, the Neo-Thomists in France, or Freud in Austria...were not ‘anti-Marxists’. They simply regarded Marx irrelevant, by and large. And Marxism itself, which had thrown up a galaxy of thinkers and of political leaders before 1914, did not after World War I produce one single figure, even of the second rank.”<sup>70</sup>

While it is clear that many politicians lost the confidence of their people in the aftermath of the Great Depression, the role of economists during the crisis is somewhat contentious. Many see the stubborn defence of the gold standard, which was inspired by economists of the time, as a huge mistake that led to the unravelling of the British Empire, ended the nineteenth century globalisation period and made the Western economies more vulnerable. Hayek partly blamed his fellow economists and the advices they had been giving to the politicians for the development. “There is much to suggest that we have in fact become more tolerant towards particular abuses, and much more indifferent in inequities in individual cases, since we have fixed our eyes on an entirely different system in which the state will set everything right.”<sup>71</sup>

---

<sup>66</sup> Hayek, 1944, p 143

<sup>67</sup> Hayek, 1944, p 7

<sup>68</sup> Hayek, 1944, p 71

<sup>69</sup> Hayek, 1944, p 140

<sup>70</sup> Drucker, 1939, xxv

<sup>71</sup> Hayek, 1944, p 218



At the same time economics evolved as a science based upon the concept of the Economic Man. Economists moved away from the ‘behavioural’ thinking of Adam Smith and embraced with enthusiasm the new mathematical tools that the idea of the Rational, Economic Man made available. The perception of the time was that “economics as a social and ‘moral’ science dealing with the social behaviour of man and with institutions devised by him, can only claim to be a science if the economic sphere is regarded as autonomous, if not as supreme, and economic aims as desirable over and above all others. Otherwise...it can supply no ‘laws’ of economic cause and effect – the criterion of science.”<sup>72</sup>

But the enthusiasm of the economists over the new theories was not matched by an analogous success in the real world. Drucker wrote 1939: “At first glance it might appear that the science of economics has never been more dominant than just now and that, therefore, the belief in the society of Economic Man could never have been stronger. Nation after nation has entrusted the management of its affairs to the trained economist. He is in demand as business executive and as political leader, as lecturer and as radio commentator. But this superficial appearance is deceptive. We have installed the economist in a last desperate effort to save the society of Economic Man, just as the eighteenth century installed the philosopher – the rationalist, ‘enlightened’, historically trained scholar on its shaky throne. And like the Philosopher-King in the eighteenth century, the Economist-Prime Minister in the twentieth century failed.” Drucker continues: “Although the professional economist seems to have the power, actual developments have been taking a course which all economists – however much they differ among themselves – had declared to be ‘impossible’. We were told that the gold standard could never be abandoned by the very men who did it. Dr Schacht, father of bilateral trade agreements, owes his reputation as a professional economist largely to his learned and conclusive exposition that such agreements cannot possibly work...and that neither in Germany nor in the United States is there as yet price inflation, appears as ‘impossible’ to the economist.... It is not that the standard of knowledge of the economists has deteriorated. It is the belief in the desirability and in the necessity of the sovereignty and autonomy of the economic sphere that is disappearing...The masses...refuse to accept institutions simply because they serve economic ends”<sup>73</sup>

Hayek drew 1944 another lesson:

“The need is for an international authority which, without power to direct the different people what they must do, must be able to restrain them from action that will damage others. The powers that must devolve on an international authority are not the new powers assumed by the states in recent times, but that minimum of powers without which it is impossible to preserve peaceful relationships, i.e. essentially the powers of the ultra-liberal ‘laissez-faire’ state. And even more than in the national sphere, it is essential that these powers of the international authority should be strictly circumscribed by the Rule of Law.”<sup>74</sup>

---

<sup>72</sup> Drucker, 1939, 47

<sup>73</sup> Drucker, 1939, 49

<sup>74</sup> Hayek, 1944, p 238

“We must not deceive ourselves that in calling in the past the rules of international behavior international law we were doing more than expressing a pious wish. When we want to prevent people from killing each other we are not content to issue a declaration that killing is undesirable, but we give an authority power to prevent it. In the same way there can be no international law without a power to enforce it.”<sup>75</sup>

“An international authority can be very just and contribute enormously to economic prosperity if it merely keeps order and creates conditions in which the people can develop their own life; but it is impossible to be just or to let people live their own life... if every spontaneous effort has to be ‘approved’ and nothing can be done without the sanction of the central authority.”<sup>76</sup>

“...there must be a power which can restrain the different nations from action harmful to their neighbours, a set of rules which defines what a state may do, and an authority capable of enforcing these rules. The powers which such an authority would need are mainly of a negative kind: it must above all say ‘no’ to all sorts of restrictive measures.”<sup>77</sup>

In a specific discussion about Europe he writes: “Nineteenth-century liberals may not have been fully aware how essential a complement of their principles a federal organisation of the different states formed; but there were few among them who did not express their belief in it as an ultimate goal.”<sup>78</sup>

Politicians did to a certain extent respond to the concerns of Hayek at the end of the Second World War, but they did not go as far as he proposed. They put their trust in an inter-governmental order without the authority of an international legislator.

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.

---

<sup>75</sup> Hayek, 1944, p 239

<sup>76</sup> Hayek, 1944, p 234

<sup>77</sup> Hayek, 1944, p 238

<sup>78</sup> Hayek, 1944, p 241. Hayek make references not quoted here.

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 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 when it comes to enforcement that matches its global reach, which makes the WTO different from most other international organizations.

This inter-governmental order has served the world reasonably well, but it has not been able to prevent a Second Return of Un-Checked Capitalism.

### **Liberalized financial markets**

Some highlight the collapse of the Bretton Woods system of fixed exchange rates in 1971 as a watershed in the present globalization process. Before the breakdown of the Bretton Woods system it was seen as desirable to control the flows of 'hot money'. As Keynes explained: The Bretton Woods agreement gave every government the "explicit right to control all capital movements" on a permanent basis. "What used to be heresy", he said, "is now embraced as orthodoxy"<sup>79</sup>

The deregulation of the financial markets followed a re-evaluation by leading economists of the benefits and dangers of free capital flows. It followed an abandonment of Keynesianism and adoption of market liberalism during the seventies and early eighties. This is perhaps the most interesting development from a theoretical point of view as it so directly affected the

---

<sup>79</sup> vgl. Keynes, p 17,1980

globalisation process. But it was not the only paradigm shift. It coincided with a similar discussion in political science around public regulations.<sup>80</sup>

The public interest theory of regulation had dominated the field for a while. It took a benevolent view of regulators and saw them as rational, trustworthy, disinterested, and public-spirited experts who produce rules that ensure general economic efficiency and maximum welfare for society. The rules pre-empt or remedy market failures and address welfare problems. They can ensure that the economies of scale and scope encountered by monopolies are benefitting the wider community in a fair way, prevent the monopolists to abuse their market power, enforce safety and quality standards and the like.

Capture (or special interest) theorists of regulation<sup>81</sup> saw the public interest approach as naïve and took the view that politicians often were self-interested and venal, selling regulatory policy to the highest special-interest bidder able to sway votes, either directly or through campaign contributions. Companies, bankers, doctors, lawyers etc want to prevent new competition and raise the barriers for entries to their market and the political process is thus according the theory prone to regulatory capture by such special interests. The reasons why there is so little opposition to this sad state of affairs is according to those theorists, mainly two. One is the high cost to acquire information. The other is that while the profit for the capturers is high per capita, the loss for the average citizen may be low.

The conclusion of the capture school of regulation was that the cost for regulation often is higher than the benefits, a conclusion that supported the market liberals claim that the financial markets should be deregulated. Capital mobility would allow global savings to be allocated more efficiently, channel resources to their most productive use, and raise economic growth. The IMF recognized the risks but claimed that the benefits of free capital flows would outweigh the costs.<sup>82</sup> The adoption of market liberalism by the IMF was contrary to the original vision. The IMF was not created to liberalize the financial markets, but rather to step in where markets fail and mitigate the effects of unchecked capitalism. The purpose of the IMF and the World Bank was initially to facilitate balanced growth of international trade, stimulate employment and real income and develop the productive resources of all member countries.<sup>83</sup>

The deregulation of the financial markets strongly 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 propelling 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. Many economists have seen liberalization of the capital flows as inevitable given this global development.

---

<sup>80</sup> vgl. Mattli and Ngaire, 2009, p 9

<sup>81</sup> vgl. Mattli and Ngaire, 2009, p 10-11

<sup>82</sup> vgl. Fischer, 1997

<sup>83</sup> vgl. Woods, 2006, p 2

The liberalization of the global financial markets, have unleashed a ‘hot money’ market of speculation, something Keynes most likely would have predicted, had he been alive. 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.

The financial market actors are often heralded for their innovativeness, and not seldom express pride over their international reach, new products and technological advancements. However, it is not a development without risks. The knowledge among investors of the foreign markets in which they 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 as a consequence increased. The new instruments also enable the actors to ‘create their own money’ using the leverage the instruments offers.

### **The Second Return of Un-Checked Capitalism**

The first major financial crisis following the deregulations of the financial markets hit East and South East Asia in 1997 and it spread to Brazil, Argentine and Russia. Just before the crisis the IMF and other observers heralded several of the countries for their progress; but when the crisis hit they all tried to blame the run on the countries on perceived problems. They did not want to see the obvious, that Keynes and the economists of his generation had a point, namely that unregulated ‘hot money’ can create financial crisis without substantive grounds. Jeffrey Sachs was one of the few recognizing that the crisis was a financial panic largely unrelated to economic fundamentals and internal weaknesses.<sup>84</sup>

“The Western economies have since then experienced two financial asset bubbles within one decade; the first one was the Internet bubble that was linked to over-optimistic predictions on the uptake of internet services. The issue was not that the forecasters were fundamentally wrong, but that they over-estimated how fast the use of internet would grow. The market is now where the optimists of 1999 thought it would be 2002; new ‘cool’ technical solutions have been found, which makes the business models of the internet boom look ‘stone-age’, quite a typical development during the breakthrough phase of a new technology. The guardians did not intervene when the stock prices skyrocketed, but they issued warnings that those that speculated on the market did not listen to.

There were some lessons learned by the central banks and the regulators from the burst of the internet bubble. Creative accounting and conflicts of interest led to irresponsible auditing; banks had been making money on IPOs at the same time as they had been rating the companies. To avoid a similar incident again the stock exchanges, the financial regulators and the central banks issued new directives, forced auditing firms to sell off their consultancy

---

<sup>84</sup> vgl. Radelet and Sachs, 2000, quoted by Rodrik, 2011, p.94

arms and banks to better separate their businesses. Managers in some of the companies that had been the most creative in their accounting had to face trials.

The bursting of the Internet bubble was in itself not a very dramatic thing. It led to necessary corrections of the share prices on a couple of stock markets and the bankruptcy and down-scaling of a number of companies, but the effect on the economy in 'the real world' of the bubble burst was quite limited. What really hit the US economy hard at the time was instead 9/11. The shock made the US economy go into a temporary 'standstill'; a psychological effect countered by Alan Greenspan (followed partly by European central bankers) as he brought down the interest rates to almost zero. As an unintended side-effect a new asset bubble started to develop; trillions of available dollars started to look for a better return than the central banks' 'zero' rates. Financial institutions started to lend money carelessly, ignoring the third-party risks. Bad loans were packaged in complex 'structured products' and sold around the world to unsuspecting pension funds, public institutions and private investors. Their losses were enormous when the new bubble started to burst. In hindsight the financial regulatory regime has clearly been too laidback. The commercial development of the new products mainly took place in an unregulated system, a system in which there was not the same accountability or demand on capital coverage as in the ordinary banks. There were those, including Congress committees, that criticized the lack of regulation, especially in relation to the hedge funds, which is one of many types of actors in this financial 'secondary' bank market; but Alan Greenspan and other central bankers rejected the requests for increased regulation.

Many have questioned whether the old generation at the helm of the banks really understood what their younger colleagues, who had so much higher marks from Harvard and Yale than they themselves once had, were up to; 'I did not buy the products because I have never understood them' the straight-talking Warren Buffet has declared. But how many of the older actors in the financial world have had such high self-esteem to be able to admit in front of young brilliant collaborators that they do not understand something they are supposed to understand? If they had, their 'thymos' - their own self-image and how they are recognized by others - would have been threatened. With a global savings surplus looking for returns and triple A ratings from the ratings institutes it was easy for the young financial wizards of Wall Street and their friends in the City to sell the products to the world.

When the bubble burst the trust in the financial system waned; a deep recession in the real economy followed contributing to a second wave of losses in the banks. Unemployment soared and many saw the value of their houses decline, finding themselves with negative equity. When banks stopped lending to one another due to the perceived risks, a lack of liquidity on a global level developed, and companies found it difficult to get financing deepening the recession further. Central bankers have responded by a massive issuing of new money and governments have stimulated their economies by borrowing money from countries with an account surplus, mainly China and the commodity-rich countries. The lack of liquidity on a global level has hit the developing countries particularly hard and the IMF has been forced to intervene in some cases. As the finance crisis turned into a sovereign debt crisis the IMF got a more prominent role than it had had for many years. The IMF has

together with the EU helped to 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.”<sup>85</sup> When the IMF intervened it had, in line with the Washington consensus, but contrary to the road chosen by its main financier, the US, requested the countries to contract their public expenditure, leading to in many cases an accelerated fall in asset prices and increased unemployment. But since then the IMF has reconsidered its position and is now a voice of reason in the European debate.

In a declaration<sup>86</sup> after a meeting in Washington that has been retrieved but was public for one day, the Leaders of the Group of 20 described the root causes of the crisis:

‘During a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. At the same time, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions. Major underlying factors to the current situation were, among others, inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes. These developments, together, contributed to excesses and ultimately resulted in severe market disruption.’

“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. President Obama has not included the critics of the old regime among his advisers, but the ones he has chosen have ‘reformed’ their own thinking. Economists in central banks and finance ministries around the world are now looking for economic models that give a better representation of the markets.

It is not that such models are readily available. The critics of the Washington Consensus have shown the shortcomings of the old theories. It has been quite a while since the Nobel Prize Winner Joseph Stiglitz showed how asymmetric information distorts the markets and he and others have repeatedly criticised the recipes that the IMF and others have issued based on

---

<sup>85</sup> Dahlsten, 2010, pp 107-108

<sup>86</sup> Published on [www.whitehouse.gov](http://www.whitehouse.gov). Retrieved the day after. Also quoted in Dahlsten, 2010, p 108.

their incomplete models.<sup>87</sup> Stiglitz has lately together with Paul Krugman, Amartya Sen and Jacques Attali advised the French President Nicolas Sarkozy to take a wider look at the economy and include environmental and other impacts in the decision process.”<sup>88</sup>

However, “it is not until the last decade, more or less, that the computing power and computational knowledge has been available to create alternative models to the ones used by central bankers and finance ministries. Those responsible for economic modelling are now with increasing interest looking at the opportunities that are available to them, especially on how to create models that are based upon a representation of ‘real’ people acting on the market, so called agent-based models. It is a challenging proposition and it will take many years to develop such models and an intense cooperation between institutions, economic researchers and computer scientists, but this expressed interest is creating hopes for the future.”<sup>89</sup>

The latest financial crisis has added a layer to the global governance in one important way. At the outbreak the leaders of the main economies acted in concert. 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 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<sup>90</sup>, outlining deepened cooperation between the twenty countries. The countries agreed that this work, mostly organised 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 the 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. The 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

---

<sup>87</sup> See e.g. Stiglitz, 2007

<sup>88</sup> Dahlsten, 2010, pp 111-112

<sup>89</sup> Dahlsten, 2010, p 112

<sup>90</sup> Published on [www.whitehouse.gov](http://www.whitehouse.gov). Retrieved the day after.



to ensure that they permit an orderly wind-down of large complex cross-border financial institutions. Strengthened capital requirements for banks and structured credit and securitization activities were proposed. Risk management was to be improved; especially the systemic risks of credit default swaps (CDS) and over-the-counter (OTC) derivatives transactions were to be reduced. 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.”<sup>91</sup>

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 per cent of the values of their houses, giving them space to absorb a future loss of value on their properties.<sup>92</sup>

The problem is that the proposed actions have been insufficient and that they have been unevenly implemented.

The former Economy and Finance Minister of Greece Yannis Papantoniou, who has a first-hand experience of a failed economy, highlighted in a recent report<sup>93</sup> some of the missing elements:

- Effective Regulatory Framework. The Basel agreements needs to cover all institutions and purpose-built legal entities prevented.
- Strengthened Supervision. Resources must be built up and independence ensured.
- Resolution. No institution should be allowed to be "too big to fail". The IMF has proposed a "pragmatic approach" to cross-border resolutions, still to be determined.
- Regulating Systemically Important Financial Institutions (SIFI). Extra surcharges for these institutions should be discussed.

---

<sup>91</sup> Dahlsten, 2010, p 109

<sup>92</sup> vgl. Dahlsten, 2010, p 110

<sup>93</sup> vgl. Papantoniou, 2011, pp 10-12

- Reinforcing Market Infrastructure. Better regulation is needed of over-the-counter (OTC) derivatives, naked short-selling and Credit Default Swaps.

Some of those concerns can be solved on national and regional level, such as the resolution question, but many concerns are global in character and demand global approaches. The truth is that those concerns have been growing in scope and depth as time has evolved. The drawbacks of an unregulated global financial market are becoming more and more obvious. The list of unsolved issues is starting to be quite worrisome, which adds to the concerns of Papantoniou.

**First.** The 2008 financial crisis has made it clear that market actors with global reach who have gone astray can create considerable damage to the international financial system. The unregulated system is spreading financial ‘diseases’ like plagues around the world. Banks are supposed to borrow short and lend long, but as the financial markets have become more ‘sophisticated’ the possibilities to make money on short placements widely outweigh the potential profits from the financing of real investments, entrepreneurs and small businesses. The ‘Shadow Banking’ system and the ‘new’ departments of the banks are where you can make the six- or seven-figure bonuses and that is where all ‘the-best-of-the-best’ of the young talented economists from the business schools are heading. The objective of the liberation of the financial markets, namely to better allocate money in the real economy, has become a neglected side business. The well-known and interesting libertarian economist Tyler Cowens main concern when it comes to the stability of the financial system 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 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".<sup>94</sup>

**Second.** The markets have often created runs against states. The common wisdom is that those runs are rational as they punish the misbehaviour of countries, and it is clear that Germany has used the market forces to install fear and remorse in unruly Southern European nation-states. Chancellor Merkel and her followers among the Prime Ministers in Northern Europe have sometimes sounded like modern times Hoovers, as they argue that the hardship of unemployment and loss of income will teach the Southern Europeans a lesson. But they have been playing with fire and there will ultimately be a price to pay for everyone. The liberated market forces cannot be expected to be turned on and off at the will of political leaders.

---

<sup>94</sup> Cowen, 2011, p.9

A laid-back analysis shows that it is not the countries who are the most debt-laden (if public and private debts are added together) and who have the weakest public finances, which are the subjects of the market speculation. If that had been the case the UK e.g. would have been in deep trouble and not the beneficiaries of extremely low interest rates. No, the speculators put their bets where they smell political indecisiveness and weakness. In the case of the US and the UK they know that the governments can respond to any runs by increasing the money supply. The European approach, which has been to follow and not to lead the markets, has unintentionally released a huge playing-ground for financial speculators. If the EU decision-makers had hit the market with the sledgehammer day one, we could have had a quite different development. A complication is that the politicians in charge have to answer to their domestic constituencies and their perceptions and not to the Europeans as a group. They may act logically given the preferences of their citizens while collectively acting unproductive.

The former ‘tiger economy’ Ireland is worth a reflection. It was a real estate bubble that pushed the economy into a dark hole. Before the event few saw any problems in lending money to the Irish state and the Irish banks. The economy had been steadily growing and had enabled the Irish state to reduce its debt to a comparatively low level, less than forty per cent of GDP. The rating institutes gave both the Irish State and the banks very high marks. OECD, the EU watchdog ECFIN and ECB warned about the asset price increases, but they were mostly seen as an unfortunate side-effect of the fact that Ireland belonged to a Euro zone in which countries were growing in different speeds. The banks in the City of London, who are supposed to be the most advanced in the world, and are geographically close to Ireland, were among those that lent the Irish banks the most money. They relied upon the rating institutes and saw no warning signals. When the asset bubble burst and several banks faced collapses the Irish state took over the debts and the state suddenly turned from a trusted solvent state to a debt-ridden one.

**Third.** Many claim that there is a counter-productive incentive structure that has to be addressed. Cowen is one of the critics, although he also says that "we probably do not have a solution to the hazards created by our financial sector, not because plutocrats are preventing our political system from adopting appropriate remedies, but because we don't know what those remedies are."

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 maximising 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.<sup>95</sup>

---

<sup>95</sup> See Martin, 2011

**Fourth.** There are few mechanisms to stabilize the markets. There is no lender of last resort. The IMF was not created to handle a crisis emanating from a malfunctioning of the financial market in its largest member states. In an era of globalization where there is an increasing demand for financial stability and clear rules the international financial institutions have no authority. Of special 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 has continued to be appropriate. But when the global economy is starting to pick up, so is the ‘recycling’ of liquidity. If the 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 are also those who question the ability of the central banks to control the liquidity at all. The financial markets can with the help of the new instruments in practice create money and put money at risk that formally does not exist.

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 latter 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. The demand for industrial capacity building has come down as the replacement investments in the East have been cheaper than the earlier investments in the West. The services sector that is playing a larger and larger role in all countries is also demanding less investment in relation to its contribution to GDP than the agricultural and industrial sectors. The investment opportunities in real capital in relation to the global GDP have thus decreased. However, those employed in the services sector are saving as much as those employed in industries or on farms, and they are doing it mainly to support their pension schemes. Those savings are substantial, but in a Chinese perspective they pale; the ordinary Chinese save as much as 50 per cent of their income.”<sup>96</sup> As a consequence of this development and the change of their relative competitiveness, some countries - China and the commodity-rich countries - have large saving surpluses, while others - the US, the UK and the Euro zone - are borrowing heavily. In a perfect market, this imbalance would be corrected by an adaptation of the exchange rates. The Chinese yuan would appreciate and the dollar, the pound, and the euro depreciate, but this is not happening as the currencies are being manipulated. A second “automatic” defence mechanism is the interest rates, but they are for other reasons not flexible enough.

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

---

<sup>96</sup> Dahlsten, 2010, pp 110-111

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. The asset bubble will eventually burst and the values of the savings will have to be written down.”<sup>97</sup> This pattern seems to be more or less inevitable as long as we do not have proper global market governance. It also signals a 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.

**Fifth.** Of special importance for the global stability is the money looking for returns on the global market. It is estimated that 9 trillion dollars are kept in ‘tax havens’. This amount could be compared with the total private savings in the US that are in the order of two trillion dollars. Another aspect of importance is the growing currency reserves. They were 2004 about three billion dollars of which less than one trillion dollars were to be found in the Chinese reserves. 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 positive current accounts, while the US, India and other emerging and developing countries had negative current accounts.<sup>98</sup> The EU has now as the crisis has evolved joined the US as an ‘over-consumer’. The growing imbalances that assemble currency in some hands and make others dependent on the willingness of the ‘rich’ to lend some of their reserves to the ‘poor’ contribute to the development of the global financial market.

There is no sustainable currency regime. The present situation in which some countries are assembling huge saving surpluses while others are large borrowers is not sustainable. Currencies are perceived to be manipulated, creating a market volatility that is tampering business and destabilising the global economy. One proposal, floated in the Group of 20, 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 individual countries such as Germany and France as they are members of a currency union, the Euro zone.

**Sixth.** 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 for many years, based on the triple A

---

<sup>97</sup> Dahlsten, 2010, p 111

<sup>98</sup> vgl. Martin Wolf, Financial Times, 6 April 2011

ratings from the rating institutes, thought they had invested in something both profitable and safe.

**Seventh.** There is no global financial regulator. The Euro zone is when this is written on its way to get a common regulator, which is a step forward. But the G20 has only so far been able to agree upon increased cooperation. Central bankers and financial regulators meet to discuss but there is no whip forcing them to binding conclusions; many issues are left unsolved, such as the third-party risks and asymmetric information.

**Eighth.** A severe problem is the uneven implementation of agreed regulations. It is dependent on decisions by the parliaments in every single country. Papantoniou expresses concerns that some countries, especially the US and the UK, have a too laissez-faire attitude and his concerns seem to be relevant. 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. The light touch regulation applied by the UK has historically been seen as a competitive advantage for the City of London and many want to keep it. Lord Turner of the British regulator the Financial Services Authority (FSA) has in a testimony to a committee within the British Parliament<sup>99</sup> complained that he has been under pressure from the government to apply a light touch regulation and that he, before the latest crisis, was discouraged to intervene, although the excessive lending culture had created concerns within the FSA.<sup>100</sup>

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?’<sup>101</sup>, the British journalist Robert Peston has given a scathing description on how those actors have been able to steer the actions of the British 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’.”<sup>102</sup>

It is not fair to see the lack of coherent implementation as only a 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 loop-holes. 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. Financial actors who are operating internationally can steer their activities to places with the most convenient regulations. The only way to avoid this ill-fated situation is to have global governance with

---

<sup>99</sup> vgl. Lord Turner, Daily Telegraph, February 26, 2009

<sup>100</sup> vgl. Dahlsten, 2010, p 110

<sup>101</sup> See Peston, 2008

<sup>102</sup> Dahlsten, 2010, p 112

legislative powers that can make the threats by financial actors to move their businesses to the country with the least rigid regulation ineffective.

**Finally.** The overshadowing problem now is that governments, just as during the Great Recession, are focusing on how to satisfy the financial markets and not on how to decrease unemployment and satisfy the needs of their citizens. It is a situation that is under-mining the legitimacy of both the governments and the global market economy. The political system has to become the governor of the global financial markets and not their servant. That unleashed financial markets support the real economy in an insufficient way would not have surprised the visionary economist Irving Fisher, who already 1935 proposed some radical steps in order to enforce a focus on the real investments.<sup>103</sup>

### **Many consequences**

The present problems in the marriage between the public order and the market economy are strongly linked to the power of the unregulated financial markets. But the problems have not evolved over night and there are other problems. The political scientist Wolfgang Streeck has in an interesting analysis shown how the marriage between capitalism and democracy has gone from minor crises to more severe crises. The first post-war crisis developed during the 1970's as labour unions demanded higher increases of the wages than the productivity gains motivated. The result was severe inflation which was not halted until the chairman of the Federal Reserve Bank Paul Volcker raised interest rates to an unprecedented height, causing unemployment to jump to levels not seen since the 1930's. Streeck writes: "[T]he conflict re-emerged in the electoral arena. Here it gave rise to growing disparity between public spending and public revenues and, as a consequence, to rapidly rising public debt... When efforts to rein in public debt became unavoidable, however, they had to be accompanied for the sake of social peace by financial deregulation, easing access to private credit, as an alternative route to accommodating normatively and politically powerful demands of citizens for security and prosperity."<sup>104</sup> The financial crisis of 2007 exposed the hollowness of this approach and nation-states had to socialize the losses that banks and other financial institutions had encountered, when lending carelessly, 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 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. Countries have taken on more debt than they can handle.

The power balance in the marriage between democracy and capitalism has been reversed. The governments are no longer in control; the financial markets are. Streeck asks: "Now the issue is how far states can go in imposing property rights and profit expectations of the markets on

---

<sup>103</sup> See Fisher, 1935

<sup>104</sup> Streeck, 2011, pp 23,24

their citizens, while avoiding having to declare bankruptcy and protecting what may still remain of the democratic legitimacy”<sup>105</sup>, and he ends by giving a fairly negative prognosis.

Nation-states can, as pointed out by the philosopher Robert Nozick, force citizens to contribute to causes or actions they dislike. The citizens have historically de facto had no possibility to say no<sup>106</sup>. There are especially two types of situations that are the most common. In the first kind, which can occur in democracies, and which is the one Nozick discusses, it is in principle demanded of those who are better off to transfer some of their created wealth to those who are less well off. Experience shows that the rich within reason are prepared to do that. But if they are pressed too hard they can and do revolt. That happened in many of the European welfare states in the 80’s. Many of the rich moved their money and themselves to countries with a more ‘reasonable’ taxation. The rich voted no with their feet. This has become possible in a market economy that is increasingly global. The rich are not “locked in” the way they were in the 70’s when Nozick wrote his famous book. It took a while but the countries with the high taxes on the rich have now adapted to the reality that they do not control their rich citizens and have lowered the capital taxes on fortunes; with the result that the rich sometimes are moving back, but not in a scale and a form that has made them as taxable as other citizens. The finances of the Western states have been undermined by the regulatory arbitrage that global companies and wealthy citizens have been able to exploit and this is one underlying reason for the crises that Streeck have identified.

The simple truth is that there is a growing mismatch between the territoriality of the nation-states and the market economy. While most states have boundaries that are stable and uncontested, at least externally, the market economy has outgrown those boundaries and become more or less global. This is putting a strain on the marriage between market liberalism and democracy that has become a hallmark of the Western world. The German philosopher Jürgen Habermas who uses the term ‘embedded capitalism’ to describe the European form of ‘liberal democracy’ is arguing that the epoch of the embedded capitalism is over and that the globalized markets are running away from politics.

The European Union was originally envisioned as a peace project, a way of ensuring that Europe would not be the cause of a Third World War. But over time the benefits of a common market and a common approach to the market economy has become apparent. Besides agricultural policy the EU of today is mostly concerned with the four freedoms of movement – the free movement of people, of labour, of capital and of goods and services. Europe has developed a Single Market that is an astounding success in itself. But the European Union has, with the exception of trade, not been able to act as one in the global arena and has not been able to create an alliance on global level that would pave the way for proper governance of the global market economy. The latest Euro zone crisis has shown both how much that still needs to be done internally as well as a European dependence on and weakness in relation to the global financial markets.

---

<sup>105</sup> Streeck, 2011, p 24

<sup>106</sup> vgl. Nozick, 1974 pp 173-174. The de facto situation occurs e.g. when the citizens concerned are in a minority in a democracy. Also in Dahlsten, 2010, pp 62-63



Europe starts to see a return of mass unemployment in a number of countries, a widening of the gaps between the have and the have-nots, unfair global competition and unaddressed global environmental challenges – all the hallmarks of an unchecked capitalism. The financial markets are setting limits to what most individual governments can do, limits that create unrest among citizens. Several countries, including more advanced economies such as the UK as well as more traditional economies such as Greece and Hungary had undisciplined budget regimes at the time of the financial crisis and now find it difficult to reign in the deficits. 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 had no part in.

As this is written the focus in the public debate is on the Euro zone and the possibilities to save the euro and the European Project. There is a potentially dangerous perception that the global challenges will fade away if the problems concerning the Euro zone are solved. However, few of the problems discussed when it comes to the financial markets are regional in character; almost all are global. Having noted that, there are issues that relate to the Euro zone as such and to the fact that it is a currency union. Those challenges can only be addressed by the Euro zone countries themselves. On the global market not only companies, but also countries, compete, and there is a wide field of actions that countries (and regions) can undertake to become more competitive and to make their economies more sustainable. The European countries have e.g. 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. There are other concerns left unsolved.

Some, like the German Chancellor Merkel, see the solution in further integration. She argues in favour of a fiscal union, followed by a banking union and finally a political union. She has made it clear that she is not prepared to risk German taxpayers' money without such a roadmap. The problem is that the fiscal union and the austerity measures Chancellor Merkel have demanded have contributed to a deepening of the negative effects of the financial crisis. As the crisis has turned into a sovereign debt crisis, especially in the Euro zone, politicians and economists have focused on meeting the perceived demands of the markets and not on 'the despair of the masses', especially not on unemployment. The objectives for the leaders of Greece, Italy, Spain and other countries burdened by debts have been and are to implement austerity measures that can diminish the need for future borrowing and make it credible that the countries can repay their debts. There are a couple of intrinsic problems with that approach. The first is that the economists who are advising the politicians are using traditional models of the economy, which have proven to be inadequate, even misleading, at the time of crisis. The recipes that the models predict and that originally were recommended by e.g. the IMF to be followed by the countries concerned have been tested in a number of cases with mixed results. Financial balances have often been regained, but not until after a long period of decline in living standards and heavy unemployment. Joseph Stiglitz<sup>107</sup> and others have criticized the prescribed methods because of their human costs. Some have pointed to the recent experiences of Argentine and Brazil; Argentine adopted the IMF way, while Brazil

---

<sup>107</sup> See e.g. Stiglitz, 2006

chose another route, prioritizing growth and jobs, and there is little doubt about which country that has been the most successful. The conventional economists on the other hand point to how Latvia has turned its economy around through heavy austerity measures; the price has, however, been a permanence of high unemployment, widespread criminality and prostitution. The Latvians re-elected their government, but many claim that it is the recent experience of an even worse system, the communist system, that has made the Latvians compliant; only 14 per cent in a recent poll believe market economy to be a good system.

It is not a given that the Italians, the Spanish and the Greeks will be as submissive. The populations of the Southern European countries are beginning to express the same despair in front of unemployment and the loss of hope as the populations in continental Europe at the time of the Great Depression. Many start to turn against both the political and economic order. Chancellor Merkel and her allies may therefore unintentionally play in the hands of those who wish to see a dissolution of the Euro zone and maybe also of the European Union. If the economists and politicians now in charge in many European countries only concentrate their efforts on austerity measures in order to meet the concerns of the financial markets and neglect the mass unemployment many see a risk, that we will see a repetition of the unrest of the thirties, and a popular rejection of the global capitalism and national democracies; and what is more: As the Prime Ministers put in charge can be perceived as instruments of Berlin, Paris and the Brussels Elite the anger may be directed towards the European Project as such.

Is there a risk that we are we facing the same scenario as in the 30's? Rodrik sees a difference. "In the decades since, modern industrial societies have erected a wide array of social protections – unemployment compensation, adjustment assistance and other labor market interventions, health insurance, family support – that mitigate demand for cruder forms of protection such as sheltering the economy behind high tariff walls. The welfare state is the flip side of the open economy."<sup>108</sup>

However, a recent encouraging development is that the IMF has started to question the rationale for the stern austerity policies. Correcting steps may be taken in order to stimulate growth and jobs, even if the space is limited. Leaders in the troubled countries will have difficulties to deliver the growth and jobs that their constituencies are demanding, simply because they do not have access to the necessary tools. They are dependent on a global economy on which they have little influence. The end game of the Euro zone crisis may also come to worsen the problem. Whatever the outcome the costs to borrow money for Euro zone countries as a group are likely to be considerably higher than before the crisis, hitting not only long-term growth, but also the interest of individual countries to borrow. Countries that have been put under 'guardianship' are especially unlikely to want to borrow more on the international market than they absolutely have to. The demand for loans for investments in the Euro zone may as a consequence decline, further deepening the global imbalance between savings and investments.

---

<sup>108</sup> Rodrik, 2011, p 19

I am not discussing the Euro zone questions in this paper, as I see the management of the global market economy and a currency union as two very separate questions. A currency union is in my reasoning a federation of nation-states and should seek solutions as such. Chancellor Merkel has been right in saying that a currency union demands a fiscal union, a banking union and a political union, but has in my view acted illogically when not recognizing the Euro zone economy as one economy and the need for the ECB and the Member States to stimulate that economy.

For the purpose of this inquiry it is enough to notice that it as things now stand is difficult to see how Europe can be able to return into growth without a banking system that supports the real economy and without the possibility to tax its richest citizens and companies. Europe needs most likely the support of a global order that can control the down-sides of an unregulated global market economy, if it is to recover.

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. Many protesters have succeeded in claiming more human rights and democratic decision-making, but 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.

The United States had a relatively balanced increase of exports and imports until the end of the 1990's. It was the ability to innovate and exploit new technology discoveries in the areas of IT and medicine that held up the exports. But since 2000 the exports have increased only incrementally. During the new millennium, the increase in GDP and domestic consumption has been financed with loans from countries with an export surplus, mainly the commodity rich countries and China. When the new President of the US decided to further stimulate the US economy even more than already decided he counted on the willingness of especially China to lend the US more money to get out of the recession and to start import again. It is a gamble that seems to have succeeded; the US has been allowed to borrow, even if the lenders cannot be certain to get their money back at the exchange rate of the time.<sup>109</sup>

It is imperative for both Europe and the US to have a balanced trade, e.g. to export as much as they import.<sup>110</sup> A country has in principle to earn, to export, in order to buy, to import; it can only to a limited extent take up loans to pay for its consumption, and then only if it can offer future value creation capabilities as security. Anyone who is trying to 'talk away' this simple fact is just wishful. The US is now leaning on its reserve currency status, but that is a short-term strategy. Economic fundamentals have always won at the end of the day. The insight that the recession has given the lenders is that the underlying value-creation capabilities of the US economy have been overestimated. US companies are thriving in the new global landscape, but that is not due to the development of their US production facilities, but due to the fact that

---

<sup>109</sup> vgl. Dahlsten, 2010, p 116

<sup>110</sup> vgl. Dahlsten, 2010, p 117

they have become global and are benefitting from the possibility to locate production wherever they like and access more markets than ever before.

Even if the Euro crisis has slightly reversed the trend, the lacklustre performance of the US economy has been reflected in the value of its currency. For lenders that is bad news. However, there is no bouncing back from the situation; it is a one-way street; the dollar and to a certain extent the euro will have to depreciate in relation to the Chinese Yuan to create a new balance; the fall of the dollar has already contributed to halving the US account deficit.

Many US politicians and officials feel let down by their successful international companies. Before joining the Obama administration as director of the National Economic Council, the economist Larry Summers complained about “a stateless elite whose allegiance is to global economic success and their own prosperity rather than the interests of the nation where they are headquartered”. The companies have little stake in the “quality of the workforce and infrastructure in their home country” and “can use threat of relocating as a lever to extract concessions.” Workers have disproportionately to wear the brunt of the pressure that global competitiveness causes, he concludes.<sup>111</sup>

Is there a simple mechanism to restore US competitiveness? Feeling powerless or possibly believing that threats will help, many in the US Congress have brought old mercantilist thinking out of the wardrobe raising all types of wishful protectionist actions to be taken in order to stop jobs from leaving the US. Some propose a trade war with China. Almost all economists, both consensus economists and their opponents, are in agreement that it is a route that only will deepen the economic problems. There are, they claim, better alternatives. The issue to concentrate on for both the US and Europe is innovation and competitiveness to ensure that we have the money to pay for our imports in the future.

A concern from both a Western and Chinese point of view is that the domestic demand in China, and also in India, has not been growing at the same pace. As a consequence imports have not balanced the export growth, in turn creating a growing trade deficit for Europe and the US particularly in relation to China. Economists have warned China not to keep the currency too low and to become too dependent on export. China has to find ways to stimulate domestic demand and to reduce the dependency on exports. If China can implement a coherent domestic pension and a healthcare reform, it 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, besides making India a more classless society

When the US economy, followed by many European economies, went into recession and their import demand tumbled the Chinese had to face a similar situation to the one the Japanese faced before them. There are several reasons why China has so far managed better than Japan

---

<sup>111</sup> vgl. Summers, 2008, quoted by Rodrik, 2011, p 86

did. The first is that China is still a low-cost country; the second is that it has an undervalued currency and has gathered substantial currency reserves, and the third is that China due to those reserves can use the state budget to heavily increase the public demand, especially related to infrastructures, when needed. 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 10 per cent 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 urgently 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 crises. 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.

### **Lessons to learn?**

We are facing a new severe crisis. So what, if anything, can we learn from the “First Return of Un-Checked Capitalism”?

It is not a simple exercise. It is easy to demand that we should learn from history, much easier than to actually do it; and it is easier to say at hindsight what one should have learned than to do it while there still is time.

It is necessary to make this qualification, for the simple reason that, even if history has a tendency to repeat itself, it never repeats itself in exactly the same way. There are similarities and there are disparities and to draw the right conclusions of those different observations is not straightforward.

An obvious similarity is the flooding of the global markets with ‘hot money’. The public order needs to regain its control of the financial markets. Other similarities are the global

interdependencies and the importance of global trade. The global trade was at the early twentieth century of the same level in relation to the concerned countries GDP as it is today. But there is also a disparity; the global interdependencies were much less complicated then; there was a flow of commodities from poor, often colonized, countries to the recently industrialized Western economies and a trickle of industrial products going back. The trade pattern of the earlier globalisation period did not match the level of interdependencies we have today, the complex weave of supply-chains and markets enabled by an IT sphere in which we all are embedded.

Another similarity is the role of economists and economic science. Politicians turned then as now to professional economists for guidance and the relative power of economists peaked. As this is written two economists with the background as Vice President of the European Central Bank and Competition Commissioner in the European Commission are acting Prime Ministers in the debt-laden countries of Greece and Italy.

The issue now as then is that the economic science is under development and that there are question marks around the conventional thinking. The recipes that the economists originally applied at the time of the Great Depression did not work, the gold standard had to be given up, desperate protectionist moves failed, industrial planning and nationalisations were unsuccessful. It was not until Keynes' thinking started to spread that methods recommended by economists started to give positive results, but then it was too late. The distrust towards politicians and economists had already reached a level that paved the way in many countries for totalitarianism, for the national socialists and for the fascists. The decision-makers had for too long neglected the despair of the masses: the mass unemployment, the inability for men and women to support their families and their children, the horror of a new young generation growing up without future and hope. The economist Dan Rodrik, whose theories I will come back to, claims that one should not draw the conclusion that inadequate models are the main cause of often questionable advices given by economists. It is a "common complaint against economists that they have a single, uniform model of the economy that relies on narrow and unrealistic assumptions", he writes "This misses the true source of the problem... Keynes, Tobin and other economists who preferred restraints on global finance had models in mind that were quite different from those that animated financial enthusiasts".<sup>112</sup>

While the gold standard and the lack of recognition of the role of budgetary policies for growth and jobs were the blind spots of the earlier economists, Rodrik suggests that the effect of a basically unregulated global financial market is the blind spot of many in the present generation. He seems to me to make a valid point. Economists sometimes talk about the verdict of the financial markets as if they were guided by rationality and raised above suspicion, as if the asymmetric information, the lack of transparency, the mismatch of opportunities, responsibilities and consequences, and the perverse incentive structures were non-existent and not mainly unaddressed problems. Hayek already 1944 noted: "Even the most essential prerequisite of [the market's] proper functioning, the prevention of fraud and

---

<sup>112</sup> Rodrik, 2011, p 132,133

deception (including exploitation of ignorance) provides a great and by no means yet fully accomplished object of legislative activity.”<sup>113</sup>

There is a need to improve the economic tools and get a better understanding of how the economy really works and there is a research, sometimes called Global Systems Science, that aims at giving a better representation of the world, to simulate the world as it is, rather than to assume that it can be represented by conventional and simplified theories.

The lessons learned from the failure of economists and politicians during the Great Depression and the handling of the Euro zone should be lessons learned for the governance of the global market economy.

## **V. INSUFFICIENT INTERGOVERNMENTAL GOVERNANCE**

The present governance of the global market is in practice based on two pillars. One is the exercise of military power; the other is an 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 globalisation 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 end 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, besides by history, 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. I will come back to the role of military power in the discussion around alternative future governance models. For the moment I want to highlight the obvious shortcomings of the inter-governmental order.

---

<sup>113</sup> Hayek, 1944, p 40-41

## **Multilateralism a la carte**

The supranational structure for the governance of the global market economy that was established in Bretton Woods has more or less withered away. In its place we have seen the development of governance through networking that gives every major power a practical veto. The participation in the decision-making is basically voluntary and is sometimes described as ‘multilateralism a la carte’. Even when the major actors agree on a certain action or a certain regulation the implementation is in most cases left to the discretion of each country. 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.

Right now there seems to be a standstill in questions that concerns the more controversial aspects of the regulation of the global market economy. A worrying sign is that the WTO has encountered increasing difficulties to conclude the negotiation rounds.<sup>114</sup> There is some progress made in international trade relations, but they are mainly achieved bilaterally or between trading blocks. The latest WTO 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 the 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. Financial regulations that have been agreed in Basel and between finance ministers have e.g. been watered down by the US Congress.

The progress in international governance has thus decelerated. Another example: The German Chancellor has 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. The perception is that the organizations have been more focused on defending their respective turfs than on finding common ground.

During the French Presidency the G20 discussed and initiated actions by many of the UN organizations on issues such as food shortage, commodity prices, immigration, and currency imbalances. But the general feeling is that the momentum is fading away as the G20 members are focusing on domestic (and Euro zone) consequences of the financial crisis. The former

---

<sup>114</sup> Not that everything the WTO does is uncontroversial. Stiglitz 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. See Stiglitz, 2007, p 119 - 132



Greek Finance Minister Papantoniou proposed 2011 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.<sup>115</sup>

The proposal that originated 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. However, even this moderate proposal has been met with resistance. The 'bottom-up' approach is in the present climate a slow and cumbersome process.

The British Prime Minister David Cameron was asked by the then Chair of the G20, President Sarkozy, to report on global governance to the Cannes Summit in November 2011. His main conclusion was that the answer to better global governance is not to be found in elaborate new institutions and global architecture. He claimed: "We have the machinery that we need already. No, what we need above all is the most precious and intangible commodity – political will. Political will to act together, and to build the consensus we need to confront squarely the problems before us so that we can return our economies to health and vigour. Political will to keep tackling poor regulation, barriers to growth and global disparities in wealth. That is what our citizens are entitled to expect of us. And that is what we must deliver."<sup>116</sup>

Cameron continues: "The G20 is unique in bringing together the political leaders of the world's major economies – advanced and emerging alike – on an equal footing. From its birth in economic and financial crisis, it has been an informal and Leader-driven group focused on building political consensus...Informal mechanisms to generate and sustain political consensus are a valid and essential part of global governance, working alongside and complementing the work of institutions whose members have more formal rights and obligations."

The G20 that represents 85per cent of the world economy must become much more consistent and effective at engaging non-members, international institutions and other actors, welcoming their effective participation in specific areas of the G20's work, Cameron suggests.

Cameron is highlighting improved monitoring and surveillance. The IMF should e.g. enhance its surveillance role by updating and codifying its multilateral surveillance function to drive further improvements in its ability to monitor global risks, he says.

Cameron recognizes: "The financial markets have become the most integrated and interlinked part of the global economy. International coordination of financial standards and of their implementation by the competent authorities is critical for the maintenance of financial stability. A number of bodies have evolved over time to promote and contribute to such

---

<sup>115</sup> vgl. Papantoniou, 2011, p 14

<sup>116</sup> Cameron, 2011, foreword

coordination, but the crisis demonstrated that they were unable to sufficiently resolve conflicting regulatory standards, to drive action to respond to significant lags or gaps in the development of these standards or to prevent arbitrage caused by their uneven implementation in different jurisdictions.”<sup>117</sup>

At the same time he sees progress made under the leadership of the FSB and suggests that the way forward should be to strengthen the FSB, to let it become a legal entity with a permanent secretariat so that it can continue to effectively address some of the underlying problems that led to the crisis. These include reviewing and coordinating the work of the Sectorial Standards Boards (SSBs); undertaking surveillance of macroeconomic and financial risks together with the IMF; and supporting contingency planning for managing cross-border financial crises. Cameron recognizes that regulatory arbitrage in the global financial system remains a real threat which undermines market and economic confidence. To counteract this, he suggests that the FSB should more clearly exercise its mandate to advise on and monitor the meeting of regulatory standards. The FSB could also play a more central role in providing authoritative assessments to prevent allegations of non-compliance in some jurisdictions as a justification by others for not acting.

He also wants to enhance the WTO’s efforts to monitor free trade agreements, identify protectionist measures and recommend remedies to rectify them. The international institutions, especially the SSBs, should promote future standards to become more global in nature.

He proposes that the issue around a secretariat of the G20 should be solved by secondment from the member states and that a Troika consisting of past, present and future presidents is created.

Cameron’s proposals are to summarize built upon two pillars: Political will on one hand, and monitoring and surveillance on the other.

Cameron recognizes that there is clearly a need to strengthen the overall coherence, looking more broadly at the institutions grappling with the current and future challenges of economic globalisation but claims that this is a much larger subject than could be addressed in his report.

But he defends his limited proposal. There are a large number of established institutions and processes tackling challenges in cross-cutting areas such as energy, the environment and development that needs to be given clearer and stronger political direction to work together, analysing global problems and proposing actions in a more joined-up way to achieve common goals. To create new bodies would consume huge amounts of political energy, he argues, and in today’s fast-changing world, challenges often evolve more quickly than institutions can be restructured to address them.<sup>118</sup>

---

<sup>117</sup> Cameron, 2011, 2.12

<sup>118</sup>vgl. Cameron, 2011, 2.16-2.24

Dryzek and Dunleavy reflect upon the situation: “The international system has sometimes been described as an ‘anarchical society’ because historically it has achieved a large measure of cooperation without much in the way of central institutions at the system level. International law is very weak compared to its domestic counterpart, and there are few ways for international institutions to force compliance with their decisions.”<sup>119</sup> They note that political scientists are increasingly discussing the legitimacy of this order. A question posed especially for the liberal democratic states is if the rise of networked governance is democratic. Dryzek and Dunleavy write: “Electoral democracy means accountability of governments to the voters; but if collective outcomes are not in the end produced by the sovereign state, it is hard to see how such accountability can be arranged... Sometimes the very informal character of networks means that it is hard to determine where decision making authority actually lies.” However, “some theorists insist that all governance really represents is a flexible way for governments to operate that retains ultimate government control”<sup>120</sup> ; a claim that raises another question, namely the lack of coherent implementation of agreed actions.

Post-structuralists see a sovereign state dissolved into power networks that do not stop at national boundaries. Marteen Hajer suggests “that contemporary processes of ‘globalisation on the one hand and individualisation on the other’, multi-level governance, complexity, novelty in the character of policy problems, new sites and forms of political action and undermining of expert authority, often lead to an ‘institutional void’. That is, when a problem arises on the political agenda, it may be unclear where (if anywhere) responsibility for its resolution can be located, and the character of the polity itself must be negotiated along with the nature of the problem and possibilities for collective action”<sup>121</sup>

### **What the global market economy is lacking**

The actions Cameron proposes are mainly in the form of more monitoring and reviewing. That is a far cry from the international legislation and rule of law advocated already by Hayek in 1944.

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 globalisation process proceeds.

The development of the global market economy is demanding a similar set of rules that mostly exist on national<sup>122</sup> 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

---

<sup>119</sup> Dryzek and Dunleavy, 2009, p 17

<sup>120</sup> Dryzek and Dunleavy, 2009, p 148, 149

<sup>121</sup> Dryzek and Dunleavy, 2009, p 297

<sup>122</sup> In the case of EU on European level

importers need clear rules and a level playing field. A lack of governance shows up 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 a diminished sovereignty of nation-states, especially if they are dependent on the global financial markets in order to finance public deficits. The collecting of sufficient funds to finance the activities of the nation-states is also undermined by the possibility of wealthy individuals and companies to use regulatory arbitrage. The nation-states find themselves in an unpredictable global environment on which they have little influence.

That the state has a role in regulating the market economy is generally recognized. The following elements are central to a functioning global market economy and those are areas which the individual states cannot in a meaningful way control and regulate on their own (the list, which is in line with common views by market liberals on the role of the state<sup>123</sup>, is not intended to be exhaustive, more to be illustrative).

- Regulation of the financial markets.
- Establishing and enforcing laws of contract.
- Preventing overt coercion of individuals by others.
- Rules for acquisition and sales of assets.
- A common foundation for the exploitation of natural resources.
- Competition rules and regulation of unavoidable monopolies.
- Recognition of Intellectual Property Rights
- Ways of internalizing "externalities", such as environmental impacts, into the market economy system.

The globalisation is in itself also demanding a regulatory framework that is outside the scope of the nation-states. Four examples of such missing elements in the framework are regulations that support

- Free and fair trade
- Basic labour and migration conditions.
- Stable currency relations and global money supply
- Fair domiciliation of companies and citizens for taxation.

### **An order at the end of the road**

Can the present inter-governmental order with its focus on consultations and monitoring deliver the regulatory environment, of which I have given some examples, and which is needed in order to steer the global market economy in an efficient way? Prime Minister Cameron seems to believe that, and argues that more of political will is the main answer to the present challenges, not more power to global institutions.

---

<sup>123</sup> vgl. Dryzek and Dunleavy, 2009, p 108

However, there are some problems with the approach. The political will is defined not by the global needs, but by the mandate that the leaders have been given by their national constituencies. That mandate is often too narrow. Just one, but an important example: Recent history has shown that key countries have been easy victims of heavy-handed lobbying from the financial industry in the implementation phase of the financial regulations and standards that have been agreed upon in international consultations; the effect has been that the implementation has been incoherent and patchy. Is it realistic to expect that more of consultations and increased monitoring and reviewing will change the influence over the decision-making by the financial elite in the individual countries?

There are other common challenges than the stability of the financial markets. All externalities are e.g. not automatically taken into account in the global market economy. The most obvious case is the effects on the global environment. Ruthless companies may, if not restricted, be 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 are patchily addressed are the social conditions under which production is taking place. Abuse of the local work forces is far from always prevented, child labour is forbidden, but implementation is wanting, and minimum wages for exporting companies are discussed, but not agreed.

The lack of a level global playing field when it comes to externalities, Intellectual Property Rights (IPRs), competition rules etc. is an issue. A global IPR regime could e.g. improve the interest worldwide in making real investments compared to financial investments.

An additional reason why the present order is offering insufficient governance is that the organizations have different voting power systems. 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 G20 exercise all its political clout to try to coordinate the actions within the UN family. The IMF has another decision-structure that is more aligned with economic realities, but its scope is limited and the organisation has a historic luggage that makes it an unlikely candidate for a wider role.

The final reason is that 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 a future governance structure that can be pro-active,

coherent, transparent and effective on the basis of the existing organisations is an awkward, if not impossible task.

To sum up: The conclusion is that the existing governance of the global economy is insufficient. 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.<sup>124</sup>
- 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. There is no one to blame if we enter into a new financial crisis. There is no one to take responsibility if climate change will become irreversible. In the present situation there is no one else to blame, than the more or less unregulated global economy as such.
- Undermined 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 based upon inter-governmental and functional networking order is at the end of the road. It does not deliver the global regulation in the common interest that is needed and it is dependent on a political will that is solely defined by the diverse national interests.

## **VI. THE IMPROPER, INADEQUATE OR IMPOSSIBLE ALTERNATIVES**

For societies to function they need systems with structures and governance and those systems are not always perceived as human constructs to be changed at our will; sometimes the systems start having a life of their own. Religious fundamentalists often impose a way of life

---

<sup>124</sup> vgl. Dahlsten, 2010, p 118

on their followers, on which they have little say, promising rewards in a life after death. Societal systems can sometimes be perceived as larger than life, worth dying for. Many of the young protesting at the Tahir Square in Cairo made clear that they were prepared to do just that to claim their rights and a regime that listens to the needs of its people. How the society is organized determines the outreach and the limits of people's lives and if the system in place hinders them from living their dreams and desires they may see the fight for another system so crucial as to overtake the goals of their own lives, goals they could not have met had the old system remained in place anyway. In the good society everyone can find a place and a space. We want, to quote Immanuel Kant, to be treated not just as means, but also as ends.

“All political philosophy including economic theory, and not just our modern thinking, has been more or less deductively leaning on perceptions of what it is to be human and of human behaviour. Philosophers expect people to respond in one way or the other to the different elements of their reasoned, often idealised, systems and the governance that is implied, and the effectiveness of any such system is dependent on the possibility to predict the human responses. Earlier generations of political scientists and philosophers have, however, by necessity had, explicitly or implicitly, to base their reasoning on an intuitive understanding of the human nature and on simple models; the human brain is very complex and the ability to scientifically study it has been very limited until now. The philosopher Francis Fukuyama describes the temporality of the philosophies underlying the modern Western societies, and their dependence on a perception of human nature, in the following way:

‘Contemporary liberal democracies did not emerge out of the shadowy mist of tradition...they were deliberately created by human beings at a definite point of time, *on the basis of a certain theoretical understanding of man*<sup>125</sup> and of the appropriate political institutions that should govern human society.’<sup>126</sup>

Researchers now know much more about how the brain works and how and why we humans act and behave the way we do. The research is still in early phases and the knowledge is far from complete. While some old questions have been answered and many features have been better understood, new horizons are at the same time opening up and new challenges are discovered. There is fantastic progress under way, thanks not least to the fact that there is a growing and very fruitful cooperation between scientists from all fields; psychiatrists, psychologists, physicists, neuroscientists and philosophers are learning in a constructive way from one another.<sup>127</sup> But the progress should also be put into perspective. The new findings have not always added to our understanding, but rather vindicated some ways of thinking about human nature and weakened other, less substantiated, views.

We have reasons to come back to this evolving knowledge as we address alternative models for governance of the global market economy.

---

<sup>125</sup> My italic

<sup>126</sup> Fukuyama, 1992, p 153

<sup>127</sup> Dahlsten, 2010, p 14 and Dahlsten 2011, p 3

The marriage between market liberalism and the nation-states is strained; the market economy has outgrown the territoriality of the nation-states and become global, and the inter-governmental and networked order of which the purpose is to reduce the conflict has come to the end of the road. It no longer produces the necessary legislatively binding and enforceable regulations, and the more or less unrestricted global financial markets are of special concern. We need, to use the language of the complexity economist Eric D Beinhocker, shape the fitness environment,<sup>128</sup> of the global market economy, nothing more, and nothing less.

I will not only address the question of institutional supply but also discuss the need for broad and sustained demand as argued by Mattli and Woods. There is a strong linkage between the public reasoning and the institutions. A Public Information Space, to use the terminology of Will Hutton, is a precondition for public reasoning and the space needs an institutional support, even to be seen as an institution, in order to enable a free exchange of views. It is easy to recognize malfunctioning in the present public reasoning due to information overload and manipulation. People are forced to put their trust in information sources that are not always reliable. Public reasoning cannot replace institutions but needs them to be free and open.

I will discuss the alternatives that have been introduced in the debate, start with de-globalisation and re-nationalisation, then turn to the likelihood of a new imperial order, move from there to self-regulation and complete the Tour d'Horizon by addressing the recurring dream of a global government. After having critically discussed all the alternatives and having found them wanting I will introduce my suggested alternative: separate World Market Governance.

## **1. RE-NATIONALIZATION IS NOT THE ANSWER**

There is no one (at least not to my knowledge) who has developed the arguments against the on-going 'hyperglobalization' as convincingly and as coherently as the Harvard economist Dani Rodrik. I have already quoted him a couple of times and will continue to do it. In his latest book 'The Globalization Paradox – Democracy and the Future of the World Economy'<sup>129</sup> he sums up his research and offers an alternative, mostly evidence-based, narrative to the mainly belief-based narrative of the mainstream economists of our generation.

To me he is a modern Karl Marx: His analysis is sharp, identifies issues that many mainstream economists have put a blind eye to, and he invites a serious discussion. The problem is that Rodrik's recipe, just like the recipe proposed by Marx and his followers, is unlikely to work. To be honest to the reader, I am convinced that it will not work and I will try to explain why.

---

<sup>128</sup> See Beinhocker, 2006, p 426

<sup>129</sup> See Rodrik, 2011



Rodrik starts from where we are: "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."<sup>130</sup> Rodrik sees a Political Trilemma of the world economy. "We have three options. We can restrict democracy in the interest of minimizing international transaction costs, disregarding the economic and social whiplash that the global economy occasionally produces. We can limit globalization, in the hope of building democratic legitimacy at home. Or we can globalize democracy, at the cost of national sovereignty... We cannot have hyperglobalization, democracy and national self-determination all at once."<sup>131</sup>

Theoretically this leaves us with three alternatives according to Rodrik:

1. A combination of Hyperglobalization and the Nation-State
2. A combination of Hyperglobalization and Democratic politics
3. A combination of the Nation-state and Democratic politics

Let us start with the first alternative. In the present hyperglobalization the financial markets have the upper hand according to Rodrik, and I share that view. They put a "Golden Strait-jacket" on the nation-states, just like the in the periods when "the rules of the game – open borders, protection of the rights of foreign merchants and investors – were enforced by chartered trading companies or imperial powers."<sup>132</sup> "In this world, governments pursue politics that they believe will earn them market confidence and attract trade and capital inflows: tight money, small government, low taxes, flexible labor markets, deregulation, privatization and openness all around."<sup>133</sup> The financial markets are forcing a run to the bottom of social conditions, corporate taxes etc. In short they are undermining the possibilities of nation-states to fight unemployment and offer the citizens social protection. This is where we are today and I share the view that this is no attractive alternative.

In the second alternative the nation-states are 'dropped' rather than democratic policies. "This is the 'global governance' option. Robust global institutions with regulatory and standard-setting powers would align legal and political conditions with the reach of the markets and remove the transaction costs associated with national borders... Taking this idea to its logical conclusion, we can envisage a form of global federalism – the US model expanded on a global scale... or we can imagine alternative forms of global governance, not as ambitious as global federalism and built around new mechanisms of accountability and representation"<sup>134</sup>. Rodrik refutes this alternative not only on practical grounds, but also on substantive. "The democratic legitimacy constraint virtually ensures that global governance will result in the

---

<sup>130</sup> Rodrik, 2011, p xvi

<sup>131</sup> Rodrik, 2011, p 200

<sup>132</sup> Rodrik, 2011, p 202

<sup>133</sup> Rodrik, 2011, p 201

<sup>134</sup> Rodrik, 2011, p 202,203

lowest common denominator, a regime of weak and ineffective rules”<sup>135</sup>. I share the view that a global government that undermines the nation-states is an undesirable – and unrealistic – alternative. I will come back to why in a following chapter and will then use some of Rodrik’s arguments.

This analysis leaves Rodrik with the third alternative: To drop Hyperglobalization in favour of a ‘Smart Globalization’, a reinvention of the Bretton Woods-GATT regime for a different era. The alternative, which Rodrik calls Capitalism 3.0, could strengthen the national democracies, he claims. He bases the “re-nationalization” on seven principles.

1. Markets must be deeply embedded in systems of governance
2. Democratic governance and political communities are organized largely within nation-states, and are likely to remain so for the immediate future
3. There is no ‘one way’ to prosperity
4. Countries have the right to protect their own social arrangements, regulations, and institutions
5. Countries do not have the right to impose their institutions on others
6. The purpose of international arrangements must be to lay down the traffic rules for managing the interface among national institutions
7. Non-democratic countries cannot count on the same rights and privileges in the international order

The first five of those principles are fairly unproblematic, at least on the face of them, but the two last principles raise many questions. To reduce the international relations to be interfaces between national institutions would be a big step backwards and why non-democratic countries should agree to give democratic states (however they are to be defined) preferential treatment is a question left un-answered.

Rodrik’s principles are followed by a number of concrete proposals that makes the reasoning even more problematic.

*Trade negotiations* should focus on expanding the manoeuvring room for individual nations rather than narrowing it further through cuts in tariffs and subsidies. Rodrik especially argues in favour of export subsidies, and import-substitution policies. Countries should have ‘opt-outs’ from the trade agreements based on domestic norms and social arrangements, prevention of the erosion of domestic regulations, or development priorities. “Advanced countries could seek temporary protection against imports originating from countries with weak enforcement of labor rights when these imports worsen working conditions at home. Poor nations might be allowed to subsidize industrial activities (and indirectly their exports) when those subsidies contribute to a broadly supported development strategy aimed at stimulating technological capabilities.”<sup>136</sup> WTO panels should no longer base their decisions on substantive grounds,

---

<sup>135</sup> Rodrik, 2011, p 204

<sup>136</sup> Rodrik, 2011, p 255,256

but solely on procedural grounds. “They would examine the degree to which democratic requirements were fulfilled. Were the views of all relevant parties, including consumer and public interest groups, importers and exporters, civil society and organizations, sufficiently represented? Was all relevant evidence, scientific and economic, brought to bear on the final determination? Was there broad enough domestic support in favour of the opt-out or safeguard in question? The panel may rule against a country because the internal deliberations excluded an interested party or relevant scientific evidence. But they would not be able to rule on the substantive claim”<sup>137</sup>, Rodrik writes. The presumption is that the procedural conditions would give democracies a leeway that would be denied authoritarian regimes.

*Abolishment of Most Favoured Nation conditions.* “If the safeguard is a reaction to labor abuses in a particular country, it is appropriate to direct the measure solely against imports from that country.”<sup>138</sup>

*Regulating Global Finance.* Rodrik argues that all countries should be allowed to introduce their own financial regulatory regime. Stronger democratic accountability to national parliaments would according to Rodrik reduce the influence of technocrats and base regulations on the preferences of a wider group of domestic constituencies. The differences will allow for regulatory arbitrage and, to avoid such arbitrage, Rodrik proposes restrictions on cross border finance. “Governments should be able to keep banks and financial flows out – not for financial protectionism but to prevent the erosion of national regulations.”<sup>139</sup>

*Fewer restrictions on labour flows.* Rodrik argues in favour of temporary work permits issued by developed countries to be circulated among citizens in developing countries. It is unclear to me how this proposal, which makes some sense, is dependent on the choice between Rodrik’s three alternatives. It seems to me that it can be implemented regardless of that choice.

It is easy to feel sympathy for Rodrik’s proposals given the increased basically unrestricted power of the global financial actors, how unpredictable their actions are, and how helpless countries are in dealing with the effects of the unleashed ‘hot money’ market. He rightly points out that the decision makers neglect “the system’s major defect, which is its lack of widespread support among ordinary people.”<sup>140</sup> There is a legitimacy crisis in the making.

But his recipe on how to address the problems will not work and this is why:

*Military power.* The present multilateral, mainly inter-governmental order has replaced a Westphalia system, in which the relations between states were decided by their relative military strength. If we take away the inter-governmental order, we will not return to a system in which countries unilaterally can decide upon trade policies, financial regulations and the like, but to a system in which military, and often financially stronger countries can impose

---

<sup>137</sup> Rodrik, 2011, p 254

<sup>138</sup> Rodrik, 2011, p 256

<sup>139</sup> Rodrik, 2011, p 264

<sup>140</sup> Rodrik, 2011, p 252

their will on weaker countries. It is already happening. Bilateral trade agreements are often combined with security arrangements, arms sales and the like. Rodrik gives himself examples on how stronger parties are either forcing weaker nations to submission and/or backing up authoritarian regimes that lack popular support. “China is widely blamed for running roughshod over human rights and good governance in Africa in its quest for national resources”,<sup>141</sup> he e.g. writes.

The Most Favoured Nation principle, which Rodrik wants to abolish, serves as a protection for developing countries against blackmail from the richer countries. They can often say no to indecent proposals by referring to that principle. With the dismantling of a multilateral trade regime and common financial standards the developing countries will on the other hand be easy victims of abuse.

*The power of financial actors.* Enormous fortunes have been assembled by a limited number of financial actors with the help of the unregulated market for ‘hot money’, and the actors are continuing to enrich themselves as they speculate on possible defaults and on future higher interest rates in debt-ridden countries. Rodrik recognizes the immense power of these actors, but at the same time blames economists for offering the politicians the faulty advice to deregulate the financial markets. Without those advices the financial actors would never have got away with it, he claims. It is a question of hen and egg. We are in a period in which economists play a major role, but I would claim that they would not have been able to play that role without the backing of Wall Street and the City. Rodrik’s work is impressive as it is mainly evidence-based but on the issue of democracy he is the victim of a belief system that has lost its appeal to political scientists. When Rodrik describes political processes he does it in the ‘pluralistic’ tradition that dominated US political science during the 70’s and 80’s<sup>142</sup>. The way he describes how the WTO panels would work above is just one example. Neo-pluralists and post-modernists would disagree with the perception that all interested parties are given the same due consideration in the political process. The US system would not pass the WTO panel test as proposed by Rodrik. It is no secret that a candidate to be elected to the Senate and the House of Representatives needs strong financial backing, and no one can offer such backing the way the financial actors can. It is very difficult for a candidate to be elected without the support of Wall Street, and when in office he has to remember who put him there, if he is to be re-elected. Dryzek and Dunleavy write “Elite theorists note that financial elites can hire the best lobbyists to make sure that legislation and regulation are to their liking, and they control privately-owned media. They often point to the common background of business and political leaders; the social clubs and networks to which they belong; the revolving door between business and governmental positions.”<sup>143</sup>

Rodrik believes that the ‘technocratic’ views, supported by Wall Street, will be less influential in national decisions than in Basel, but he forgets that it was the officials in the US, who had

---

<sup>141</sup> Rodrik, 2011, p 274

<sup>142</sup> See Dryzek and Dunleavy, 2009, p 131 onwards

<sup>143</sup> Dryzek and Dunleavy, 2009, p 71

bought into the Washington Consensus, that convinced the rest of the world about the benefits of financial deregulation. It was not the other way around.

*There are alternative industrial policies.* Rodrik quotes the Harvard Business School innovation expert John Lerner stating, “virtually every hub of cutting-edge entrepreneurial activity in the world today has its origins in proactive governmental intervention”.<sup>144</sup> There is a lot of evidence supporting that conclusion, but when Rodrik wants to open the door for protective tariffs, undervalued currencies and the like he underestimates the space for industrial policy already agreed in the WTO treaties. Countries are allowed to support research and development until the first commercial series of a new services and products. The US, which is the home of the Washington Consensus that rejects industrial policies, is the country that has negotiated the widest exceptions to allow for the most advanced industrial policy of all Western economies. There is an alternative to the Rodrik proposal and that is to stop telling developing countries to ‘Do as we tell you’, but to allow them to ‘Do as we do’.

*Democracies are in a minority.* Rodrik’s objective is to give democratic states the possibility to divert from the free trade rules and other global arrangements. Authoritarian states are not supposed to have that opportunity. They will e.g. not pass the procedural tests for “opt-outs”. One of his main arguments is that relaxed global commitments will enable developing countries to adapt practices such as export subsidies and import-substitution policies that suit their individual situation. The catch is that very few of these countries are democracies, and if they can be regarded as such, they most likely still have miles to go in order to defeat corruption and ethnic discrimination. They will not pass Rodrik’s test. Rodrik claims that China could implement export subsidies that could enable them to revalue their currency and be more open to competition, but forgets that he has proposed procedures that make it impossible for China to implement such changes, as they will not pass the democracy test. The Western countries may like it in substance, but that is not what the test will be about. Finally – Rodrik’s proposed international institutions will demand a new treaty with all concerned countries as signatories, but he does not answer the obvious question why a country like China would accept a treaty that so obviously will give the US and the Western countries benefits from which China and most developing countries are excluded.

*The return of protectionism.* Rodrik argues that there is little to gain from more globalization, but does not answer the question what can be lost in de-globalization. The measures that Rodrik proposes in order to increase the competitiveness of individual countries and protect social and cultural diversity can easily turn into a snowball. Politicians will be faced by demands like: ‘If you protect them, why not us?’ This is what happened at the time of the Great Depression and the risk is obvious that history will repeat itself. We have the same underlying problems with mass unemployment that is likely to increase and a growing distrust in our systems. Not even the powerful financial actors may be able to stop the snowball to turn into an avalanche.

---

<sup>144</sup> Rodrik, 2011, p 157

*There are too many losers.* For anything to happen it must be possible to build a coalition of ‘winners’; the superior alternative is always a win-win situation. But in Rodrik’s recipe there are too many on the losing side. The financial actors would be the main losers, not only those who speculate on the hot money market with their own money or others, but also all those who are employed to serve the actors. Managers will see their high salaries and huge bonuses wither away. (To be honest: This will be the case in any serious proposal). International companies that are the backbone of the global economy will also be losers and are likely to fight the re-nationalization. Developing countries will not be able to use their new freedom as they have no international system to protect them from the abuse of militarily and otherwise stronger countries. The emerging economies will feel discriminated against as the rule book would exclude also them from using the “opt-outs”. In short there will be no queue of countries wanting to sign up to the treaty and there will be many lobbying against it.

*There is no trilemma.* My claim is that we do not have to choose between globalization, the sovereignty of nation-states, and democracy. What we need to do is to my mind to recognize that we have two different systems, one bottom-up market economy that has outgrown the nations and one top-down political system in which the nation-states is the most natural building block. They meet different aspects of human nature and serve different purposes. What we need is a regulation of the global market economy that enables it to do its job, while empowering nation-states to do their job.

## **2. A NEW IMPERIAL ORDER IS NOT IN THE WAITING**

The human struggle for recognition will become a recurrent theme in this inquiry. Hegel saw the willingness to sacrifice one’s life as the feature that made man man. “Physical strength has always been admired as well as feared, since the ownership of such strength implies the possibility of its use. This has been a permanent fact of life at individual level as well as at collective level. School children learn how to abuse to gain respect or how to avoid a conflict with the abusers. Criminal gangs have learned how to scare people into paying them for ‘protection’, and have also developed internal pecking orders based on the ruthless use of violence. Countries have learned how to use military force to conquer and colonize other less militarily strong, but often commodity-rich, nations. The exercise of military force can be seen as the ultimate expression of collective ‘thymos’, the wish of the citizens of one country to be recognized by the citizens of other countries as superior.

Scientists who have tried to understand the rise and fall of empires have made a connection between the willingness of the citizens to make sacrifices in wars and the build-up of the empires and, likewise, between the reluctance to make such sacrifices and the down-falls of the empires.

The citizens have not always wanted the wars. The Enlightenment movement saw the recurring wars in Europe rather as a proof of the ‘megalothymia’ of stubborn princes and fanatic priests

It is a fact of life that the relative wealth of the Western world has been built partly on the use of military force. It is also the underlying presumption of the present Westphalia world order that the relative power of nations is decided by their military strength. The international institutions that have been built after World War II in order to avoid military solutions to all kinds of problems reflect the relative strength that the Westphalia order gives countries. The more militarily powerful a country is and the more prepared it is to use that power, the more influential it is on the affairs of the world.

Franklin D Roosevelt made the decision at the end of World War II not to attempt to establish world supremacy based on a unilateral exercise of military power; he and his successor could possibly have achieved it and there were members of Congress that urged them to strive for it. But most US citizens wanted the US to start taking care of its own problems and to, as far as possible, withdraw from solving the problems of others; the majority of the citizens wanted a period of peace. There were moreover the realities on the ground to consider. The US and the UK were emerging as winners in the war, but so were the hard-line communists in Moscow. In the world view of FDR and many US citizens the West had to accept this fact in order to win peace. The road FDR and his successor chose was thus to accept a split of Europe in a Western and Eastern part, develop international law and create international institutions such as the United Nations to enforce it.

In the Western European part the US helped rebuilding the democracies as well as the economies through the generous and far sighted Marshall plan. However, not all West-European states became democracies again at the end of World War II, some of the fascist regimes from the pre-war period remained in place for quite a while, the Franco dictatorship in Spain being the most prominent. The US also stayed with a military presence in Western Europe to prevent history to repeat itself, i.e. to impede the type of military build-up in Europe in search of revenge that happened after World War I. Later the military presence became motivated in order to protect the vulnerable European states from Soviet Union aggression and to show US commitment in case the Soviet Union would make any military moves. For this, Europe is indebted to the US that still is offering Europe a much needed military support.

In Eastern Europe the other winner of the Second World War, the communist dictator Stalin, created an empire built on fear and oppression as he installed puppet regimes in the Baltic satellite states, in Poland, Czechoslovakia, Hungary, Romania and Bulgaria. All opposition was forbidden and persecuted, hopes of a return to democracy shelved.

The intention of the UN was to create a mechanism to resolve world conflicts in a peaceful way, to offer an alternative to the way of war. Someone has called the UN "the indispensable organization", an organization that would have to be invented, had it not existed.

The existence of the UN has, however, not abolished the role of military power; it only offers a way of solving conflicts through the threat of use of military power. The Security Council has in many cases been involved in trying to defuse conflicts that have been developing gradually, using all available means from mediation to economic sanctions. When those

efforts have failed or have been close to failing the Security Council has used strong language that seldom directly has supported military engagement from one of the Council members, usually the US, but not excluded it either. This was e.g. the case when NATO started bombing Serbia to stop the genocide in Kosovo and when the US and the UK attacked Iraq. To reach a conclusion the military powers, which are permanent members of the Security Council, have to agree, each one having a veto. The Security Council can be seen as a mechanism that ensures that no military actions are undertaken that can lead to a new world war. The Council must not be in agreement on the necessity of the actions, but its deliberations and the veto rights of the major military powers is a guarantee that all military actions undertaken by the permanent members are tolerated.

Developed governance of the global market economy would diminish the reasons for international conflicts as it could, if implemented in the right way, offer a peaceful way to resolve many clashes of interest. It would, however, not create a world free of conflicts in which military solutions can be totally excluded.

The Presidents of the US and Russia have in a very positive development agreed not only to the prolongation of armament treaties that were about to expire, but above all to reduce the arsenal of nuclear weapons and to better control nuclear proliferation. Their common understanding was reached with the prior blessing and backing of a formal meeting of the UN Security Council in which Heads of States participated. President Obama was awarded the Nobel Peace Prize for the expectations he raised at that moment of time. In an informal meeting in Washington, to which President Obama managed to gather forty-seven Heads of States and Prime Ministers, some additional, mainly symbolic steps were taken in order to increase nuclear security.”<sup>145</sup>

As this is written the perception is that further progress has been put on a back-burner following the result of the US mid-term elections and the possible outcome of the upcoming elections both in the US and Russia. An overall issue is how sustainable a new nuclear order could have been. President Obama may have the moral support of the public opinion in most countries, but the lack of support for his efforts domestically and by one of his closest allies, Israel, is of concern to his counterparts. Iran’s ambition to create a nuclear capacity is another stumbling block.

“As of January 14, 2010, the Doomsday Clock, which is a symbolic clock face, maintained since 1947 by the Board of Directors of the Bulletin of the Atomic Scientists at the University of Chicago, stands at six minutes to midnight, one minute further away from midnight than the year before, but decisively closer to midnight than during the nineties. The closer the clock is to midnight, the closer the world is estimated to be to global disaster.

A special issue is the development of mercenary armies. History has shown that armies that no longer are deployed and supported can turn against the hand that has fed them. A

---

<sup>145</sup> Dahlsten 2010, pp 123-125



dangerous situation may quickly develop if the UN missions, to which large army units are deployed from countries such as the nuclear Pakistan, are suddenly cancelled.

The role of military power in the affairs of the world is basically an issue of national interests, values and policies and to a very little extent related to governance and institutions. There are many critics of the UN, but there are few, if any, proposals tabled that would offer any better way to control the use or misuse of military power, than the UN already offers. The question is more how to develop the international governance so that the UN will be able to exercise its role in the environment of the 21<sup>st</sup> century in a better way”<sup>146</sup>.

### **Military power and the global market economy**

Military power plays, even when it is not used, a significant role in the global market economy. Many bilateral relations are a mixture of security guarantees and arms sales on one hand and preferential access to commodities on the other. Not only the US, but also countries such as Russia, China, France and the UK, who all are permanent members of the Security Council, have such arrangements with selected countries. Sometimes the commodity-rich countries have agreements with several of the military powers. China has, as Rodrik noticed, occasionally been criticised for making such deals with regimes that has a very poor record on human rights. The counterargument is that the West has a similar relationship with Saudi Arabia, another country without democratic credentials.

The Most Favoured Nation principle puts limits to how far the preferential treatment can be expanded to trade, but as practice has shown, and Joseph Stiglitz and others have offered a lot of examples, there is not seldom a way around that obstacle.

The Westphalia order is not dead. Climate change has enabled exploitation of oil and minerals in the Arctic, and that military power is one of the considerations in the on-going discussions around the exploitation rights seems to be obvious.

The conversation around global governance of the market economy is also a discussion on how to limit the role of military power in the affairs of the world.

### **The rise of China**

A frequent suggestion is that China has the ambition to overtake the US as the world’s leading military power. They may want to do that in the longer term, but is a very far-fetched proposition that it could happen during the next decades. The cuts of military spending that are in principle (and I underline in principle) decided by the US Congress are miniscule in relation to the existing gap in military spending between the US and China. The Chinese perspective is furthermore that the build-up of its military resources is a defensive move; there are after all Tea Party members and other increasingly influential American politicians that suggest that a war between the US and China cannot be excluded. It may sound like an insane idea, but US voters seem to be increasingly attracted to candidates who make their decisions

---

<sup>146</sup> Dahlsten, 2010, pp 125-126

based on unsubstantiated beliefs rather than on a realistic view of the world. The Chinese build-up has as one major purpose to scare those nut-cases off.

If a military supreme China is a phantom, the rise of the financially supreme China is not. The imbalance between the surplus countries and the deficit countries is increasing and has trebled the last decade and a half. China has a financial power that the US and Europe lack. When the US is making financial undertakings in the Middle East and in other places it is with resources that are borrowed. The US' ability to keep its commitments is dependent on the benevolence of its lenders, of which China is an important one. The US may have a GDP that is far above the Chinese, and it may, together with the UK, be the home of the global financial centre, but it has lost its imperial status.

A common gloomy prediction<sup>147</sup> is that “we instead of an End of History<sup>148</sup> (e.g. the final victory of liberal democracy) will see an ugly struggle for world hegemony between a declining US empire and a rising Chinese super power.”<sup>149</sup> It may happen, but hardly because it would be something the Chinese would like or intend to initiate. The Chinese have a realistic view on their role in the world. They have no ambition to replace the US as the imperial power. They know that they cannot match the US militarily, at least not for many decades to come; they know that there are many other emerging economies and that demographic factors speak against them and in favour of a “multi-polar” world. 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 and Brazil are for example two other countries with a large growth potential. They have together with the other BRICS countries (Russia and South Africa) a GDP on the level of China and a joint population twice the size of China. Other countries, not at least in Africa, are also aspiring to play a larger role when the BRICS economies reach the phase in which they start to become vulnerable. The close cooperation between China, India, South Africa and (often) Brazil should not be perceived as a tactical move but rather as a strategic positioning in a world in which several emerging economies will play a major role. To see China as the leader of a new imperial order is to see the development in too simple terms and to miss what is going on in other parts of the world.

Neither will we see a G2, consisting of only the US and China. It is not in the Chinese interest to have an exclusive relationship with the US. Besides, it is a development that is vividly denied both in Washington and Beijing.

The European Union has been the largest economy in the world and the largest world trader for quite a while and individual leaders have in critical moments stepped forward. The creation of the Group of 20 at the emergence of the latest financial crisis, and the actions that the French President inspired in cooperation with the American, British, and German leaders,

---

<sup>147</sup> See e.g. Hutton, 2007

<sup>148</sup> Refers to Francis Fukuyama's famous prediction after the fall of the Berlin Wall that the liberal project had won and that we were at The End of History. See Fukuyama, 1992.

<sup>149</sup> Dahlsten, 2010, p 122

was an exceptional show of leadership. But there is a lack of collective 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.

However, the vacuum that the waning Western leadership is creating in the governance of the market economy will not automatically be filled by China.

Finally, 'Money talks!' is a common American expression, and right now that expression is losing somewhat of its American accent. But not the language of business and culture. While the US is about to lose its economic dominance, it is still successfully spreading American values and promoting the American way of life. The American culture is a missionary culture and the mission is still on. The Flemish and Walloons in the divided Belgium no longer have each other languages as their second language; they have English. The French is about to lose the position of their language in the European Union. English is now the language that the Europeans share together. The Chinese success is by most Chinese not seen as a success for Chinese values, but a reflection of their ability to adopt the successful US culture. Sociological studies show that mimicking the culture of a successful country has been a major driver of 'cultural imperialism', and the US cultural empire is still in place and growing.

### **3. SELF-REGULATION IS NO OPTION**

If you believe in the overall benefits of globalisation it may seem obvious that the conclusion you draw from the short-comings of the present inter-governmental order, especially when it comes to the global financial market, is that you need more efficient and comprehensive regulations. What speaks in favour of that presumption is that many well-respected economists, such as Alan Greenspan and Larry Summers, who argued in favour of the laissez-faire regulation of the financial markets in the 90's, have changed their minds after having experienced the disastrous results. This is, however, not the case. The Washington Consensus and the Chicago School that developed the theories behind the deregulations are still very much alive. In the 2010 mid-term elections the aggressive Tea Party candidates, that are inspired by this school of economics and financially backed by Wall Street, managed to convince an impressive share of the US' voters that the financial crisis was due not to too little regulation, but to too much government intervention. If government keeps its hands off, and Wall Street is allowed to self-regulate, everyone will benefit, they argue, and have managed to convince many of their reluctant fellow Republicans. The idea that the market is best left to self-regulation has its roots in a twentieth century misperception of the nature of man. To counter the misperceptions it is not enough to say that the recipes that they have inspired have not worked. That will not convince the politicians, or the economists; history shows that they will meet any such critique by claiming that there was something in the political conditions that was the cause of the market failure, nothing in the market itself. Instead, it is the underlying assumptions of the theories that have to be addressed.

## The emergence of The Rational Man

Something rather odd happened during the twentieth century. While the research on human nature evolved and scientists started to grasp how complex human nature is, economic and political theorists went the opposite way and adopted a simplified model of human nature, The Rational Man. It is quite a striking inconsistency in the development of scientific knowledge.

The Economic Man, as The Rational Man sometimes is called by economists, is thus a myth that has a recent birth. “Professor Emma Rothschild has gone back to the texts of the “fathers” of modern economic thinking, Adam Smith and Marquis de Condorcet, and found that they had a far more realistic view of human nature.”<sup>150</sup> The reason why the misperceptions around human behaviour became widespread during the twentieth century was neither a lack of research focusing on human nature. Already during the first part of the century researchers started to gather evidence on the inconsistencies in human nature and on how we can be unduly influenced to take irrational decisions. This knowledge has been increasingly used when developing marketing strategies and political campaigns. Many economic and political scientists and intellectuals have also taken stock of the results of the research into human nature. The economist Herbert Simon wrote sceptically of The Rational Man. The Nobel Prize winner in Economy, Gary S Becker, found behaviours that cannot be explained by pure self-interest. The economists Amos Tversky’s, P Slovic’s and Daniel Kahneman’s research<sup>151</sup> supported the psychologists’ findings around biases.

One reason for the twentieth century invention of The Rational Man may be a perception of necessity. “Tom Atkins has offered the hypothesis that economists and other social scientists became infatuated by the successful use of mathematics in the natural sciences. It was seen as a major task in economic and political theory to develop mathematical models that can predict the outcome of different decision situations, economic interventions and the like in a similar way that such models give predictions in natural sciences. To be able to use such models the economists needed a simplified model of man. The Rational Choice Theory offered such a man, and the use of him was eventually not lost on political scientists either.”<sup>152</sup>

The research based on The Rational Man theory has neither been a total waste. We humans are after all acting relatively rational, at least under ideal conditions. Some interesting insights have also resulted from the research, some that even have rendered the researchers a Nobel Prize.

The main issue is that the simplified model of man often has been misused and that far-reaching unsubstantiated conclusions have been drawn. The economists have ‘forgotten’ to tell the politicians that the results are based upon ideal assumptions and the politicians have conveniently ‘forgotten’ the footnotes. The economists have e.g. been able to show that

---

<sup>150</sup> vgl. Rothschild, 2001 referred to in Dahlsten, 2010 p 18, Dahlsten 2011, pp 4-5

<sup>151</sup> See Kahneman, Slovic and Tversky, 1982

<sup>152</sup> Dahlsten, 2010, p 169, Dahlsten 2011, p 5.

economy will function as its best, in the interest of everyone, if man is left acting on his own in line with the Rational Choice Theory. The result is sometimes called ‘the trickle down’ theory and the claim is that the fortunes made by the few will ultimately benefit all. It goes without saying that this theory has been embraced by the Political Right in many countries, mostly without the ‘footnotes’. For the Political Right the theory has offered a welcome support for the idea that the market economy is best left to self-regulation.

The belief that one person’s greed will automatically put the bread on another person’s table also solves a moral dilemma for financial actors. It has helped the Chief Executive of Goldman Sachs Lloyd Blankfein<sup>153</sup>, to continue to insist that the financial wizards are “doing God’s work”. To believe that you are on the side of the good is a strong motivator, and it gives a clear incentive, especially for those involved in the financial markets, to keep the theory alive. There is thus not only the personal credibility of many economists, but also a huge political capital invested in the theory. A lot is at stake if the political economists of this dominating school are to recognize that The Rational Man is a modern myth. The uncomfortable situation became quite obvious in the running up of the recent financial crisis. The whistle-blowers were far from silent but the system governors, mostly belonging to the consensus school, refused to listen and do what would have been needed to be done in order to avert the financial meltdown.

### **The invisible hand**

“The mechanism that ensures the legitimate outcome is often called the invisible hand. The assumptions can be split up in steps:

- There is an invisible hand that steers the markets towards equilibriums
- As man is rational this hand, and the equilibriums it creates, will deliver an outcome that will benefit everyone
- In addition a self-regulation will develop that will ensure an ethical outcome.

The first claim is in my view in principle true. The market economy is a dynamic system. And many such systems strive under certain conditions towards different forms of equilibriums (that due to disturbances and external restrictions may never occur or offer several possible equilibriums; but that is another story). However, the fact that, within constraints, there are ‘invisible’ forces pushing systems towards certain equilibriums has nothing to do with values; it is a systemic effect. An invisible hand is present in many systems, as Nozick points out<sup>154</sup> in his defence for an unregulated market economy, but a closer look at his examples shows that there are no value aspects influencing the movements of the hand. Nozick’s examples are just other types of such dynamic systems.

---

<sup>153</sup> Lloyd Blankfein in an interview in The Sunday Times of London as late as in November 2009. quoted in Dahlsten, 2010, p 6, Dahlsten, 2011, p 6

<sup>154</sup> vgl. Nozick, 1974, p 20-21

Adam Smith is often seen as the father of the concept ‘the invisible hand’. The Economist Emma Rothschild who has made a comprehensive inquiry into the Smithian thinking defends him and concludes: “What I will suggest is that Smith did not especially esteem the invisible hand. The image of the invisible hand is best interpreted as a mildly ironic joke. The evidence for this interpretation, as will be seen, raises interesting questions both about Smith and about the invisible hands of the twentieth century”<sup>155</sup>. The evidence she offers is that Smith used the term invisible hand only occasionally and then in a derogatory way. Smith was no believer in a divine invisible hand or a Stoic natural order, she shows. At one occasion he uses the term with irony when describing the political efforts of merchants to gain or retain monopolies, relying on an invisible hand to create benefits to society as a whole.

The second argument is that man’s rationality will ensure that the invisible hand should guide the economy to an ethically acceptable outcome. Rothschild suggests that three conditions have constituted the modern conception of the invisible hand: The unintended consequences of actions, the orderliness of the ensuing events, and the beneficence of the unintended order.<sup>156</sup> I will consider each of the points in turn.

On the first point she notes that Smith in his Theory of Moral Sentiments is preoccupied with what he describes as the good or bad consequences of actions upon the sentiments both of the person who performs them, and of others. The most forceful illustration of unintended consequences that he offers is, however, not good but frightful.

The attraction of the second condition, of orderliness – of orders that could have been designed – is obscure, Rothschild notices, from the perspective of the more secular thinking that dominated the twentieth century. One interpretation is that the idea supports non-intervention. The outcome could have been planned; as it happens it was not; why therefore should we have a planner?<sup>157</sup> The second interpretation, as promoted by the leading economist Friedrich Hayek, is that human actions lead to spontaneous ordered structures that are ‘superior to conscious action’<sup>158</sup> The problem with that interpretation is that it reduces the role of the independent actors, of their selfish and futile intentions, which is clearly un-Smithian.

The third condition of the invisible hand, whereby the unintended order turns out to be beneficial for the people whom it orders is even more problematic. The general equilibrium theories that have been developed in the twentieth century are making assumptions about the markets that are un-Smithian, Rothschild reflects. Smith believed that actors would take any chances to manipulate markets, create monopolies, influence politicians and the like in order to promote their interests. Smith thus not only rejected the idea about the rational economic man; he also refuted the idea of man as a genuinely moral being; he does not expect man to always act in a morally defensible way on the market place, rather the opposite.

---

<sup>155</sup> vgl. Rothschild, 2001, p 116

<sup>156</sup> vgl. Rothschild, 2001, p 138

<sup>157</sup> vgl. Rothschild, 2001, p 139

<sup>158</sup> Hayek, 1969, pp 104-105

The third argument about self-organization is developed by Hayek. He disdains the Smithian-Humian view of man as a reasoning being who is the best judge of his own interests. He believes man to be taking decisions on limited knowledge and without conscious thinking. (An interesting view as it in principle coincides with the findings that I am about to discuss). But he still believes that a beneficial self-organized social order would develop. Rothschild punctures his vision by pointing out that Hayek believes the spontaneous development of social structures to be guided by thoughtful ‘guardians’ - scholars and judges - which give enlightened and respectful advice. The Hayek society is not, as many of his followers seem to claim, a truly self-organized society.

With the Smithian perspective and the views of Hayek there is thus no intrinsic structure in the market economy, no invisible hand that ensures a rational and ethical outcome. But what if Smith and Hayek are wrong? What if man is rational?

Wherever we turn this is the key question: The idea of the self-regulated economy that gives benefits to everyone stands and falls with the idea of The Rational Man. Without him we are back to Smith’s and Hayek’s analysis that there is a need for some form of governance.”<sup>159</sup>

### **The meaning of rationality**

“It is a paradox that, while many economic and political theorists have dug themselves into a hole from which some of them do not want to escape, the issues around reasoning and rationality have attracted a wide inter-disciplinary attention. The philosophers Richard Samuels, Stephen Stich and Luc Faucher have in an overview found it helpful to mention especially three types of projects - normative, descriptive and evaluative projects.

The normative project is concerned not so much with how people actually reason as with how they should reason. The goal is, following Samuels et.al, to discover rules or principles that specify standards against which the quality of human reasoning can be measured. The descriptive project – which is typically pursued by psychologists, though anthropologists and computer scientists have also made important contributions – aims at characterizing how people actually go about the business of reasoning and to discover the psychological mechanisms and processes that underlie the patterns of reasoning that are observed. The evaluative projects, finally, aim at determining the extent to which actual reasoning accords with the set standards.”<sup>160</sup>

All these aspects of rationality are important. I will start with the descriptive projects. How do we actually reason?

### **Two different ways of reasoning**

“The common perception is that man is one coherent person. Contemporary research shows that it may on the contrary be more accurate to view the human being not as one ‘system’, but

---

<sup>159</sup> Dahlsten, 2010, pp 104-107

<sup>160</sup> vgl. Samuels, Stich and Faucher, 1999 quoted in Dahlsten, 2010, p 170 and Dahlsten, 2011, pp 6 and 7.

as a ‘system of systems’, systems that are built according to different principles and that are in constant and potential conflicts, conflicts which we humans continuously struggle to reconcile. We humans are inconsistent. The most striking finding in the on-going research of human nature is perhaps the role of the subconscious. Much more is happening subconsciously than we have been aware of.<sup>161</sup>

The researchers have especially uncovered how important subconscious processes are in most of the human decision-making. The conscious and subconscious processes often work in concert; sometimes conscious reasoning is activated, sometimes blocked. Conscious thought process regularly also involves subconscious processes, but there are also complete processes that are totally outside conscious attention. Such processes are fundamentally different from those of the conscious reasoning.<sup>162</sup> They ‘short-cut’, use stereotypes, and work in a different way to the conscious processes. This is important to recognize as the subconscious decisions can be partly based on other values and desires than those we hold consciously. Values and desires are generally acquired and influenced by the cultural environment, in which we grow up, but not all values are easily internalized in a way that affects the subconscious processes and not all subconscious desires are accepted consciously. The conclusion we draw or the action we take is thus dependent on the complex interplay of the conscious and subconscious processes, giving the issue of ‘rationality’ an entirely new perspective. Risky or non-risky behaviour in the market may express subconsciously held values.

Both conscious and subconscious processes are usually involved in everything we do.<sup>163</sup> The researchers are starting to uncover the complexity. The subconscious self is learning in a different way to the conscious self. The subconscious self is not only genetically coded, it also learns by experience (including imitation), by trial and error. That is how it learns how to walk and drive a car. On-line thinking does not have to result from culturally held values but simply from personal habits, from automatisms – from non-thinking.<sup>164</sup>

As relevant information is encountered, the subconscious self makes an evaluative judgment, but only keeps the running tally, simply retrieving and updating the summary evaluation with later information but forgetting the actual pieces of evidence that contributed to it.<sup>165</sup>

When an external stimulus is evaluated in this way in relation to the subconscious memories and values and the evaluation is leading to an automatic and fast response the process is often called a shortcut. Shortcuts are thus a type of networks that can be described as a simplified thinking.

One example may be helpful<sup>166</sup>: When you learn how to drive a car your conscious self is hard at work. Your conscious attention is on every detail of the driving. But after a while you need less and less of conscious decision-making. You drive more or less ‘automatically’.

---

<sup>161</sup> See e.g. Westen, 2007

<sup>162</sup> See e.g. Kuklinski ed 2009, pp 23, 26, 31, 129, 131-132

<sup>163</sup> vgl. Dahlsten, 2010, p 26

<sup>164</sup> vgl. Cialdini, 2001, pp 234-236

<sup>165</sup> vgl. Dahlsten, 2010, p 24

<sup>166</sup> vgl. Dahlsten, 2010, p 27



Experienced drivers can use the time in the car to relax or think of other things while the ‘subconscious’ takes over the driving. How many of us have not experienced that we are suddenly on the street of our home when we were supposed to be at the supermarket and do some shopping for the dinner? Our ‘subconscious’ has taken us to our home without disturbing us. The conscious self can intervene in the driving whenever needed. Anyone who passes from Dover to Calais or the other way around knows that you need to give the driving attention not to start driving on the wrong side. The subconscious can also alert the conscious self. It does it through creating emotions which are consciously noted. Fear or unease created by the subconscious can alert us that the situation demands our conscious attention. A helpful way of understanding emotions is to see them as a signal system from the subconscious self to the conscious self. If they are expressed as feelings or suppressed depends on how the conscious self reacts.

Sometimes it can be quite hard to teach the subconscious something new, especially if the old knowledge is ‘locked’ with strong emotions. The subconscious is filled with ‘biases’. One example: Many people are afraid of flying. They often do it anyway as their conscious self can override the subconscious self and its unjustified beliefs. The thing is that they are not unjustified to the subconscious, because what is a justified belief to the subconscious is only what is genetically coded, imitated or experienced. And the subconscious does not like the experience of flying and expresses it through creating sentiments of fear. The conscious self is strongly aware of one memory: ‘It is statistically safe to fly’ while the subconscious self is ‘locked’ to another: ‘To fly feels dangerous’. A stimulus can awake different memories held by the ‘reasoning’ conscious self and the ‘experiencing’ subconscious self.

The conscious self can be trained, and in schools it is trained, in deductive and logical reasoning. But it is impossible to reason with the subconscious. The ontology of the subconscious self refutes the epistemic norms of the conscious self. The only norm it accepts, besides the inherited beliefs and imitation, is experiencing. Air carriers know that and the programs that they have developed to ‘cure’ fear of flying is all about experiencing, basically putting the person in the situation of the pilot and let him or her ‘experience’ positive and satisfying control. That is the way to teach the subconscious self not to be afraid.

Consider Alice and Bob.<sup>167</sup> They are two singles both living in cottages in a village outside London. They have the same academic background and they are both working in the City as accountants. They are both in need of a new car as their old ones are starting to cost too much to repair. Their need of a car is basically the same; they need to get to the railway station every day and they need a car for shopping and to meet friends. By chance they have come to the same car dealer to look for alternatives. When walking around Alice’s attention has been caught by a small red car with a very personal design and of a rather un-known brand. Bob has stopped in front of a larger grey car of a recognized brand with a distinctive presence and with a strong and fuel-efficient engine.

---

<sup>167</sup> vgl. Dahlsten, 2010, pp 28-31

The emotions the cars have stirred have brought them to where they are. When they have been walking around in the premises of the car dealer their subconscious selves have been busy valuing the different options, signalling pleasure or displeasure at the different alternatives. Alice has painting as her secret hobby and is fascinated by the colour and form of things. She values beauty and is intrigued by the appearance of the small car. She can imagine herself seeing the car from the train when she gets home, feeling happy about owning such a work of art. Her value-scale and her associations are different from those of Bob. He is fascinated by mechanical toys and he is anxious to give the right impression, to be recognized by his peers. He can see his friends envy him for his new car and he can imagine the spinning sound of the engine when he accelerates from 0 to 100 km/h in 5,3 seconds. He really desires the car.

Alice and Bob happen to sit down with two different sales persons at the same time and as they are trained accountants they start to calculate the cost for owning the cars to find out if they can afford them. They both find that they really cannot meet the expenses of the new cars as things stand. They are experiencing a cognitive dissonance. On one hand they desire the new cars, an emotion inspired by the subconscious evaluation processes; on the other hand their conscious logical selves tell them they cannot afford them.

Alice that liked the red car very much, but not that much, decides to let her calculating mind win and abstains from buying the car. Besides, she did not like the sales person and she decides to go to another car-dealer next Saturday.

Bob, however, is hooked. He really desires the car and the car-dealer, who is very likeable and understands Bob, is describing the advantages of the car in a very knowledgeable way. He offers some extra features as part of the deal. They may not cost that much but they certainly increase the feeling of a very special car. The sales person has an authority about him and Bob wants to believe him. He starts to look at the calculations again: Maybe he has overestimated how much he will be driving, and perhaps he can take out costs for repair, for oil and the like; the car is after all new. And he will most certainly get a higher bonus next year, will he not? Bob has started a self-justification process to close his cognitive dissonance and to make him believe that the purchase of the car is a rational decision. He walks away happy with the contract in his pocket. The car is to be delivered in two weeks time. He is already preparing his story-line, his narrative. As his subconscious self only runs a memory in the form of a running tally it is up to his conscious self to 'invent' a consistent justification.

The Alice and Bob example illustrates how intertwined the subconscious and conscious processes are and how present they are in most decision-making. The research has beyond doubt shown that rationality is a person-sensitive thing. It is obviously also a culture-sensitive concept. It is a question that begs an answer if Alice and Bob have been acting rationally in the given example. Both have been influenced by subconscious processes that are not necessarily logical in the choice of car to start with and finally when deciding whether to buy. Alice can by economists be seen as the more rational as she ends up taking a decision that is in line with her economic interests. Alice fits reasonably well into the Rational Choice Theory, while it is difficult to see Bob's decision-making as rational in the way the theory

expects it to be. Rationality is a relative concept. With ‘rational’, reasoned evidence-based decision-making we can understand processes in which conscious reasoning in the end is ‘winning’ over emotional impulses created by subconscious processes. Decisions are deemed to be unjustified when the self-justification processes have made us believe that the decisions are rational although they are not based on sound reasoning.

It is not that decisions supported mainly by subconscious processes have to differ from those taken consciously, and mostly they don’t. When I stumble down to the corner shop in the morning to buy a croissant and a copy of *The International Herald Tribune* it is because I have tested the alternatives and have come to the conclusion that to start the morning with a café au lait and a croissant with a paper that actually is about real news is a good start of the day for me. Just because I am on ‘auto-pilot’ does not mean that I act in a different way than I would if I had sat down and consciously reflected about the alternatives.

The role of the subconscious self is steadily becoming more important as we need to make more and more choices in a short period of time and as modern societies become ever more complex. A professor in literature complained in a radio program: ‘I increasingly feel as if I am on auto-pilot. I don’t think, I don’t have time to think’. And she complained about the blogging culture. ‘There is nothing reflected in the blogs. People write without thinking; they just express themselves’.<sup>168</sup>

There seems to be a limit to how much we can consciously handle at a given moment of time. Some researchers are speculating that the reason why we have let ourselves be so influenced by branding and other emotional cues is the fact that we need that kind of short-cutting to manage our way in a society where the flow of information is steadily growing. The social psychologist Robert B. Cialdini explains:

‘Modern life is different from any earlier time. Because of remarkable technological advances, information is burgeoning, choices and alternatives are expanding, knowledge is exploding. In this avalanche of change and choice, we have had to adjust. One fundamental adjustment has come in the way we make decisions. Although we all want to make the most thoughtful, fully considered decision possible in any situation, the changing form and accelerating pace of modern life frequently deprive us of the proper conditions for such careful analysis of all the relevant pros and cons. More and more we are forced to resort to another decision-making approach – a shortcut approach in which the decision to comply (or agree or believe or buy) is made on the basis of a single, usually reliable piece of information {...} Because of the increasing tendency for cognitive overload in our society, the prevalence of shortcut decision-making is likely to increase proportionately’<sup>169</sup>, to which result stress and emotional overload contribute.’<sup>170</sup>

---

<sup>168</sup> vgl. Dahlsten, 2010, p 52

<sup>169</sup> Cialdini, 2001, pp 239-240 quoted in Dahlsten 2010, pp 27-28

<sup>170</sup> Dahlsten, 2011, pp 43-47

## The powerful self-justification process

The fact that we can hold different values consciously and subconsciously often puts us in situations of cognitive dissonance, i.e. in a situation in which we can ‘feel’ that something is in a certain way, while consciously knowing that it is another way. We may be afraid of flying, while ‘knowing’ that it is less dangerous than driving a car. We may crave to light a cigarette, while knowing that the ‘good feeling’ has no support in science. Another anecdotal example: It is a well-known fact among market surveyors that they cannot trust the answers people give about their values. A broad majority in western economies answers that they are prepared to pay more for organic food and would chose that alternative if offered to them. “But when people are shopping they act on ‘auto-pilot’ and most pick the cheapest alternative. They are steered by their subconsciously held values that differ from their conscious values. When people are asked why they have chosen the cheaper alternative a self-justification process helps them to invent an excuse to explain away the dissonance.

The findings that we humans are inconsistent, that we have a reasoning conscious self that can reach other conclusions than an on-line reasoning subconscious self is something that may be difficult to accept, particularly for us who are brought up in a Western culture. Consistency is a value that is held both consciously and subconsciously and when deciding, either through conscious reasoning or through on-line reasoning, we strive for consistency. That we in practice often take quite different decisions when acting on ‘auto-pilot’ than when reflecting is something we do not want to know as it threatens our self-image. Luckily for us we have the powerful self-justification process that ensures that we are kept in ignorance about our own inconsistency.

When the conscious and subconscious selves reach different conclusions (which they do every so often, on whether it is dangerous to fly for example) a complicated self-justification process sets in to protect ‘thymos’. The self-justification process both protects and cheats.<sup>171</sup> The process is as much about protecting ‘thymos’ and the self-esteem as it is about aligning the subconscious with the conscious self. It protects not only the self-esteem of the individual but also the esteem of the groups (‘stereotypes’) with which he identifies himself. But it also cheats the conscious self. The researchers have shown the strength of the self-justification processes; in concrete situations the self-justification processes may end up blocking the conscious beliefs, initiating self-justification processes that ‘rationalize’ its decisions, and making the conscious self believe it has taken a reasoned view. The reasoning part of the brain may even be shut down during such a self-justification process. When we are asked why we have done something without ‘thinking’ we have to ‘invent’ a justification as the subconscious self has no memory of the reason why it holds a certain belief. In this process the subconscious self can help by falsifying memories.”<sup>172</sup> There are some famous examples where people in their memoires have turned originally embarrassing situations upside down and put themselves in the quite opposite position to the one they actually took at the time.

---

<sup>171</sup> See e.g. Tavis and Anderson, 2008, Westen, Kilts, Blagov et.al., 2006, pp1947-1958, Billig, 1987, p 175

<sup>172</sup> Dahlsten, 2010, p 54, Dahlsten 2011, pp 50-51

## **The market does not demand rationality**

The market economy is not demanding rationality. When people are acting in their civil life and within the market economy they are mainly trying to meet their desires. “The drivers in people’s daily life are first of all to meet the need for survival and for reproductive success. Many basic desires are part of a genetic inheritance, but they are expanded through experiencing and by valuing. The market economy is generally accepted to be the best system ever created to meet those desires, but it is also a bottom-up system that demands that people are making decisions swiftly and on a vast scale. The on-line processing capacity of the subconscious self that helps people cope with that challenge at the same time limits the role of logical reasoning in the process. Reasoning is most likely at work when people look at contracts and negotiate prices, but the market economy as a system does not demand people to reason logically. The system works because man can act within it with subconsciously held motives that may be obscure even to him as long as he follows some simple rules. It is also a place in which man can prove himself, be recognized and build up his self-esteem. The market economy would most likely work better if everybody was well-informed and acting rationally all the time, but as every man is his own master it is not something the system demands of him.”<sup>173</sup>

“Those that have identified shortcomings in our way of reasoning such as biases and heuristics have often been accused of a pessimistic interpretation of the rationality of man and the evolutionary biologist Gerd Gigerenzer has, based on own experiments, claimed that for most practical purposes the brain reasons rationally. The differences in the results of the experiments they refer to indicate, however, that they have measured different types of cognition processes. In some cases the experiments have been set up in a way that triggers conscious reasoning, in some cases the conditions are such that the answers are given based on subconscious processes.”<sup>174</sup>

## **The death of the Myth of The Rational Man**

I have discussed the descriptive projects pursued mainly by psychologists, anthropologists, and neuro scientists. They have aimed at characterizing how people actually go about the business of reasoning and to discover the psychological mechanisms and processes that underlie the patterns of reasoning that are observed. Desires that are held subconsciously can differ from the reasoned objectives and goals that we hold consciously. It is not that they have to differ, but they do not have to be consistent. Subconscious desires are often more ‘egoistic’, less altruistic. This is among other things a consequence of how subconscious processes work and the difficulties to internalize values such as the equality of man. We all have desires that are not supported by conscious reasoning. The wish to be recognized by others may for example lead to a desire to buy a product of a high-end brand although it is more expensive and of no better quality than the alternative. We may desire a car with higher performance capabilities than we actually need. We may love a person for all the wrong reasons, or more correctly against all conscious reasoning.

---

<sup>173</sup> Dahlsten, 2010, p 56, Dahlsten, 2011, p 52

<sup>174</sup> See e.g. Gigerenzer, 1991, 83-115. Dahlsten, 2010, p 174, Dahlsten 2011, p 8

A ‘high level’ question is of course if man can be rational at all. The issue is whether he has the competence and the answer to that question is not straightforward. The ability to reason is something with which we are born, but how to do it correctly is something we are trained to do; that is after all what schools are about. The competence level varies of course between individuals due both to genetic conditions and the training or lack thereof. Experiments show that the competence with which we respond to a challenge depends also on the circumstances in which we answer. We can be distracted, deliberately manipulated, feel our self-esteem to be under threat etc. In most non-theoretical situations subconscious processes are also involved which may or may not contribute to a rational decision. There is nothing absolute about our competence to reason rationally; it is a person and context sensitive ability and the conclusions we reach are dependent on the relative involvement of conscious and subconscious processes.

“How to reason rationally is the subject of epistemology and is under constant debate. It is of interest to this inquiry under which conditions man can be expected to reason in accordance with set standards and therefore the standards themselves need to be discussed. Edward Stein has defined these standards in what he calls the Standard Picture:

‘According to this picture, to be rational is to reason in accordance with principles of reasoning that are based on rules of logic, probability theory and so forth. If the standard picture of reasoning is right, principles of reasoning that are based on such rules are normative principles of reasoning, namely they are principles we ought to reason in accordance with.’<sup>175</sup>

The philosopher Harold Brown<sup>176</sup> recognizes e.g. universality, necessity, rules, and algorithms as necessary elements of rationality but also notes that the way to reason rationally is far from uncontroversial, mentioning induction as one example. Stein, Brown and others concentrate on rationality as a way of reasoning, on what it is to reason correctly. This focus on normative standards is sometimes called deontology.<sup>177</sup> It is not an uninteresting debate for this inquiry especially as there are some proponents for what is called moral epistemology who claim that an innate moral ‘compass’ offers the best available normative standard. I will not offer any attempt of resolution of the eternal debate, but one, a rejection of the idea that man is born with moral epistemic norms.

While it is of interest how one should go about the business of reasoning to reach the most correct conclusions the focus here is rather on consequentialism, that is on how to reason correctly in such a way that you are likely to attain certain goals or outcomes. The Rational Choice Theorists are generally seen as belonging to this school of thought. Political theorists also often seem to have this approach, which makes sense as the purpose of both democracy and market economy after all is to meet the needs of people. To quote the Rational Choice proponent Michael Allingham: ‘My choice is rational, or supported by reason, if it coheres

---

<sup>175</sup> Stein, 1996, p 4

<sup>176</sup> See Brown, 1988, pp 3-37

<sup>177</sup> See Samuels, Stich, Faucher, 1999, p 22

with what I prefer<sup>178</sup>. To see rationality as a means to an end has a long philosophical tradition. Aristotle<sup>179</sup> saw rationality as an instrument for achieving ends which are not themselves determined by reason. He saw choice as desire and reasoning with a view to an end. David Hume went even further making a strong separation between means and ends claiming that ‘reason is and ought only to be the slave of passions’.<sup>180</sup> Deontology and consequentialism do not necessarily have to be in conflict. It can be claimed that to reason according to normative rules is the best way to reach the desired goals.”<sup>181</sup>

“I have so far discussed two approaches to rationality, the normative and the descriptive. It is of course the third type of project identified by Samuels et.al. , the evaluative approach, that is a challenging next step, i.e. to determine to what extent human reasoning accords with appropriate normative standards. Or to put it more bluntly: Is The Rational Man a myth or not?”<sup>182</sup>

“That he not always lives up to the Standard Picture is quite obvious. However, even with the wide interpretation of rationality applied by the Rational Choice theorists the idea of The Rational Man runs into deep problems, when evaluated in relation to what we know today about human nature. The fact that there is an inconsistency between conscious goals and objectives on one hand and subconscious desires on the other is obviously problematic. Which are the ‘rational’ preferences? In the case of conflict it seems logical to give priority to consciously held objectives and regard conflicting subconscious desires as ‘irrational’. As most of our decisions on the market are done with the help of the short-cutting subconscious there is nothing saying that the choices are rational.

Eric Beinhocker, one of the new school economists, notes that preferences are tricky, more of a logical construct than an empirical law. They are mostly, he observes, only possible to identify post facto.<sup>183</sup> The reasons are, as is explained by modern research, that the preferences are not only person but also context sensitive. To what degree we desire one product or service is decided on the spot by the relative involvement of subconscious desires and values in relation to conscious beliefs. The key critique is that conscious and subconscious objectives and desires are inconsistent and that the “rationality” of an action is impossible to predict. When we act without conscious reasoning and on the basis of subconscious processes the inference is that we may act in conflict with our conscious objectives, a fact that undermines the idea of The Rational Man.”<sup>184</sup>

In short – it is time to take a step back, to retrace the analysis from where the nineteenth century philosophers left it and to go beyond the twentieth century perception of The Rational Man, and as a consequence forget about self-regulation of the global market economy.

---

<sup>178</sup> Allingham, 1999, p 2

<sup>179</sup> vgl. Aristotle, transl. 1985, p 139

<sup>180</sup> Hume, 1740, pp 415-16

<sup>181</sup> Dahlsten, 2010, p 171, Dahlsten, 2011, pp 7-8

<sup>182</sup> Dahlsten, 2010, p 174, Dahlsten, 2011, p 8

<sup>183</sup> vgl. Beinhocker, 2006, p 319

<sup>184</sup> Dahlsten, 2011, p 53-54

## **The need for a developed understanding of the economy**

It is thus not only the governance as such that needs to be developed, so do the models of the global economy on the forecasts of which the decision-makers have to base their judgments. The traditional models are based on the Rational Choice Theory and the General Equilibrium Theory and are under normal circumstances giving reasonably reliable predictions. Man is after all, when not under pressure or undue influence taking reasonably rational decisions even if they are taken subconsciously. But the models have proven to be unreliable during the latest crisis, and have missed the effects of behaviours that are influenced by intimidation, group conformity, manipulation and other biases. The Rational Choice Theory is, as already discussed, not applicable in all circumstances.

The alternative is to base the models on simulation of the economy. Such simulations require the development of complex systems based on heterogeneous agents. The possibilities were discussed at a workshop in Brussels 1 October 2010 that I had the pleasure to chair<sup>185</sup>. The participants from the community that is using existing models of the economy, mainly consisting of representatives from central banks and other institutions, on one hand, and the research community under creation, on the other hand, agreed to try to establish a work relationship that could foster a development of such simulation models. There is a lot of work that needs to be done that also can benefit from the experiences of modelling in other research fields.

“There is a silent revolution going on in the global world of research. More than 30 million researchers from Asia, Africa and South America have been connected to the European and American electronic research networks.

These specially allocated connections enable the researchers to send and receive information in volumes and speeds for which Internet, with all its merits, has been proven to be inadequate

A university in Jakarta has built up an Early-Warning System for tsunamis with the help of German researchers. Simulation models are sent back and forth. 15 000 commands from researchers in high-energy physics from more than 70 institutions all around the world are every day processed in a grid that distributes the work from CERN in Geneva to more than 1000 computers in all continents. Doctors in Vietnam are trained in key-hole surgery from an operation done live in a theatre in Japan. By coordinating telescopes located around the globe the researchers can now see further out in space than any time before. The new technologies that are used and are about to be used are in themselves fascinating and path finding.”<sup>186</sup>

“A noticeably increasing part of the research is performed in the virtual world and a lesser and lesser part in the real world. Researchers in areas such as physics, chemistry, biology, medicine and environment have found that it is so much quicker to simulate processes than do the physical experiments. They compare the results they reach through the simulated

---

<sup>185</sup> I was at the time Principal Advisor in the European Commission and the objective was to identify the need and opportunities for future research.

<sup>186</sup> Dahlsten, 2010, p 159



processes with the results received in experiments but more and more often in order just to improve the simulation models rather than because they expect different results; they also use the simulation results to improve the theories. The confidence in the use of models as representations of the real world is rapidly increasing. This is true not only for more theoretically oriented areas such as high energy physics. It is also true for brain research, research on climate change or nanotechnologies to mention a few areas.”<sup>187</sup>

“The new IT tools thus enable the researchers and the developers to increase their productivity dramatically.

It is not just engineers or other natural scientists that have discovered how much more efficient it is to do research and development in the virtual world. Archaeologists have found that it is really time-saving to take three dimensional photos of all pieces of urns and relics that they gather and let the computers help them put the pieces together rather than doing it by hand. And when museums all around the world start to take such 3D photos of everything they have stored in their vast collections totally new perspectives on how to do archaeological research are opening up.

This new virtual world of research obviously knows no physical boundaries. If the researcher Alice is sitting in a stuffed chamber in Cambridge, in the beautiful new library in Alexandria or on the 23rd floor in the new IT tower at Tsinghua University in Beijing does not matter as long as he or she has access to the electronic research network and its connections.”<sup>188</sup> The researchers can do almost anything they want, work with anyone they want.

There are many Global Virtual Research Communities under creation. They are being built bottom-up. “There is seldom any global master plan. There is almost always a core of respected actors in the centre of each community who have taken responsibility for making proposals and manage the projects when they are funded. This core is often more or less self appointed and self recruiting. The community is normally open ended and self organizing. To become a member it is normally enough to be recruited or selected by a senior member of the community. It is up to the participants to decide on their own quite variable activity level. In the heart of a community you frequently see a common virtual workplace in which you find research results being made known before they are peer reviewed and published in scientific journals, most of which still are very traditional. On these workplaces the researchers get immediate feedback from other researchers interested in the same field.

More advanced virtual communities also share resources. They share computing capacities, share digital repositories, share simulation models and share access to sensors or other facilities. The European Union has the last decade been the biggest founder of such advanced resource sharing and virtual research communities.”<sup>189</sup>

---

<sup>187</sup> Dahlsten, 2010, p 159

<sup>188</sup> Dahlsten, 2010, p 160

<sup>189</sup> Dahlsten, 2010, p 160

The economic model builders inspired by the possibilities to simulate the global economy and its markets would benefit from the creation of such a global virtual community; the community could coordinate the data management and host a simulation model which the participants can use and collectively develop. The work is not done over night, but it is high time to get started.

#### 4. NO APPETITE FOR A GLOBAL GOVERNMENT

The dream of a global government seems to be almost as old as mankind. It has never materialised; the closest we have got are periods of imperial orders. The giant Immanuel Kant belongs to the many philosophers who have discussed a cosmopolitan world order as in present times another German philosopher Jürgen Habermas. This philosophical tradition has connected a global and, in the case of Habermas, also a European order with the exercise of some form of natural or legal rights.

##### **The dream**

A democratic global government is a dream nurtured mainly by the Political Left; the contemporary Left seems to be split between two contrarian visions – de-globalisation and a global government.

Interesting enough leading philosophers within the Political Left also seem to have accepted the idea of The Rational Man. Marx based his thinking on a rational “scientific” approach that also influenced political philosophers leaning to the Left in the Post-Socialist era.

It is thus not just the Political Right that got it wrong. None of the dominating political philosophers of the late twentieth century, the left-leaning John Rawls and the libertarian Robert Nozick, “seem to have chosen to question the accepted view of the 20<sup>th</sup> century that man can be seen as a rational being. In Rawls’ ‘initial situation’ rational men are meeting under a veil of ignorance to agree in advance on the foundation charter of their society. Rawls imagined, based on the two preconditions of truth and justice, an ‘initial situation that incorporates certain procedural constraints on arguments designed to lead to an original agreement on principles of justice’.<sup>190</sup> Since all are similarly situated and no one is able to design principles to favour his particular condition, the principles of justice are the result of a fair agreement or bargain.<sup>191</sup> In this way Rawls builds upon and develops through logical reasoning the social contract theory as found in Locke, Rousseau and Kant. Rawls argues a principle of equal basic liberties, but in contrast to Locke he defends the rights as originating from moral capacities and self-respect.<sup>192,193</sup>

---

<sup>190</sup> vgl. Rawls, 1971, p 3

<sup>191</sup> vgl. Rawls, 1971, p 12

<sup>192</sup> vgl. Rawls, 1958, p 114

<sup>193</sup> Dahlsten, 2010, p 19

But the mood seems to be changing. The twentieth century obsession with The Rational Man has been increasingly questioned. The Nobel Prize Winner Amartya Sen, in a debate with John Rawls, criticised the assumptions around man's rationality that Rawls made in his famous work on Social Justice and in his response Rawls wrote that he regretted the presumption. Another Nobel Prize winner, Paul Krugman has in different ways tried to expose man's irrationality and inconsistency. The philosopher and economist Richard Bonk<sup>194</sup> has in a recent book shown how traditional economic teachings miss the fact that humans are more than 'rational choice machines'. They are driven by an array of sentiments and creative intuition; they seek self-esteem and pride in what they do and future pleasure in imaginatively projected future selves.

The reasons why a global government has not emerged and why it will remain a futile dream is to my mind, however, not linked to man's lack of rationality. It is to be found in other aspects of human nature.

### **Man in the philosophical tradition**

There is an on-going philosophical discussion in the West on how to understand man that finds its roots, as so many other philosophical debates, in the ancient Greece. "Socrates famously envisaged a tripartite division of the soul<sup>195</sup>. He claimed that the human soul has a desiring part, which is made up of many desires, the strongest of which are hunger and thirst."<sup>196</sup> "In the Socratic tradition desires were perceived as 'static' while philosophers that have followed Rousseau and Hegel<sup>197</sup> have been highlighting the dynamic nature of desires."<sup>198</sup>

"But, Socrates notes, man can control his desires. There is, Socrates concludes, a second part of the soul, a reasoning and calculating part, which may induce man to act contrary to desire – for example when the thirsty man abstains from drinking water that he knows is contaminated."<sup>199</sup>

"Socrates called the third part of his tripartite soul 'thymos'. This is the alleged feature of man that has perhaps created the most controversy over time. In modern language it can be translated as self-esteem and pride, when using a positive language, or to vanity and 'amour-propre' when highlighting the negative aspects. To Georg WF Hegel this third dimension of the human nature is central. He calls it the struggle for recognition. And he takes it very far, claiming that no man can be seen as a full man, a 'master', if he is not prepared to sacrifice his life to be recognized."<sup>200</sup>

---

<sup>194</sup> vgl. Bonk, 2009, pp 2, 3, 296 ff

<sup>195</sup> vgl. Plato, transl. 1968, 435c-441c

<sup>196</sup> Dahlsten, 2010, p 15

<sup>197</sup> vgl. Hegel, transl 1967, paras 190-195

<sup>198</sup> Dahlsten, 2010, p 15

<sup>199</sup> Dahlsten, 2010, p 15

<sup>200</sup> Dahlsten, 2010, p 16

“Machiavelli understood ‘thymos’ as a desire for glory and his perception gave legitimacy to the claims of aristocracy for recognition of their superiority. Aristocratic pride was attacked by most Enlightenment writers, such as David Hume and Montesquieu. For the liberal movement the megalothymia of the aristocratic class was a main target. They argued that the aristocratic class in their fight for recognition destroyed rather than created wealth, that they lived on the efforts of others.”<sup>201</sup>

The philosopher John Locke, who is seen as one of the founders of the Anglo-Saxon liberal movement, tried to pit the fulfilment of the desiring part of human nature against the aspirations of ‘thymos’, hoping through social engineering to master the latter.<sup>202</sup> “David Epstein<sup>203</sup> has in an analysis of the Federalist Papers found that the importance of finding constructive and peaceful ways of meeting the need of man for recognition and prideful self-assertion was on the mind of several of the founding fathers. The founding father James Madison saw popular government – the process of running for office, debating, voting – as a benign way to indulge man’s natural pride and need for self-assertion. The American Declaration of Independence has been perceived as the final victory of Lockean philosophy when it declares ‘the pursuit of happiness’ as the main goal of society, generally interpreted as the fulfilment of material desires, especially the right to property.”<sup>204</sup>

“The most articulate critic of the liberal thinking was Friedrich Nietzsche. To him the essence of man was to value oneself, and to demand recognition of that value.”<sup>205,206</sup>

“Many philosophers, such as Thomas Hobbes and Jacques Rousseau, have tried to identify a First Man, a kind of experiment in thought to strip away those aspects of human personality that were the product of convention and to uncover those characteristics that were common to man as man. In modern language it can be seen as a search for which features are innate, genetically coded, and which are the result of education, interaction with the world, and reasoning. While Rousseau had a somewhat romantic vision of man, Hobbes had a more materialistic view of human nature. Human beings can be described and explained in purely mechanistic terms, he claimed. He understood that sensation, for example, involves a series of mechanical processes operating within the human nervous system, by means of which the sensible features of material things produce ideas in the brains of the human beings who perceive them.<sup>207</sup> Man is motivated to act in such ways as he believes likely to meet his specific desires and appetites, to relieve discomfort and to preserve and promote his own well-being.<sup>208</sup> Human volition is nothing but the determination of the will by the strongest present desire.

---

<sup>201</sup> Dahlsten, 2010, p 16

<sup>202</sup> Dahlsten, 2010, p 16

<sup>203</sup> See Hepstein, 1984

<sup>204</sup> Dahlsten, 2010, p 16-17

<sup>205</sup> See Nietzsche, 1967, p. 70

<sup>206</sup> Dahlsten, 2010, p 17

<sup>207</sup> vgl. Hobbes, 2007, I 1

<sup>208</sup> vgl. Hobbes, 2007, I 6

Hobbes' account of the First Man emphasizes his animal nature, leaving each and every man to live in a State of Nature independently of everyone else, acting only in his own self-interest, without any regard for others. Sovereign Monarchs and Native American tribes are, Hobbes argues, living in this State of Nature.<sup>209</sup> This produces what he called the 'state of war', a way of life that is certain to prove 'solitary, poor, nasty, brutish, and short.'<sup>210</sup> The only escape is by entering into contracts with each other — mutually beneficial agreements to surrender all individual interests to an authoritarian regime in order to achieve the advantages of security that only such a social existence can provide.<sup>211</sup> This idea of a social contract is also to be found in the works of Rousseau and Kant.<sup>212</sup>

"Fukuyama, who also has questioned the idea of the purely Rational Man, sees the work of a tamed 'thymos', to use the language of Socrates and Plato, in modern societies. Men do compete and they do seek recognition, but they have also accepted that the reward is in the form of fulfilment of their material desires, not in the enslaving of those that recognize them. Fukuyama agreed in the last chapter of his book called 'The Last Man' with Aristotle that all systems are incomplete in some way and speculates whether, following Aristotle, 'we might postulate that a society of last men composed entirely of desire and reason would give way to one of bestial first men seeking recognition alone, and vice versa, in an unending oscillation.'<sup>213,214</sup>

### **The struggle for recognition**

"Contemporary research has vindicated Socrates. He has been proven right in his assumption that 'thymos' is a central human feature, but also in his perception that it can be tamed; the way to tame it is through the internalization of values. The internalized values define the self-image in relation to which 'thymos' is measured and they steer the subconscious evaluation processes. The self-image is at the heart of the struggle for recognition and the self-esteem ('thymos'), as it is the self-image that we want to protect and strengthen.

Hegel was right in his criticism of the liberal suppression of 'thymos', but wrong when claiming that the willingness to sacrifice one's life was what made man man.<sup>215</sup> The latter is a value-based assumption and values are acquired. That Europeans and Americans have different views on conflict-solving may thus be linked to the fact that the 'thymos' seems to be 'tamed' in different ways in the Anglo-Saxon and the continental European cultures.

The 'thymos' is continuously exposed when man is acting on the market, as an employee or employer, as an entrepreneur or a trader. The market is a place where every day he gets feedback that affects the self-esteem and where he gets recognition by others. It is also a space in which a man's 'thymos' can thrive, especially if he has internalized values that highlight

---

<sup>209</sup> The latter example is questionable. The tribes were socially more organized than recognized at the time.

<sup>210</sup> vgl. Hobbes, 2007, I 13

<sup>211</sup> vgl. Hobbes, 2007, I 14

<sup>212</sup> Dahlsten, 2010, p 17

<sup>213</sup> Fukuyama, 1992, p 335

<sup>214</sup> Dahlsten, 2010, p 20

<sup>215</sup> Dahlsten, 2010, p 173

the fulfilment of material desires as a sign of success. ‘thymos’ seems, however, for most people (those that are not obsessed with megalothymia, i.e. a wish to dominate at any cost) to demand satisfaction, not maximization.”<sup>216</sup>

## **Group identity**

“In the discussion on the rationality of man I tried to explain how the subconscious does ‘on-line reasoning’ or short-cutting. To shortcut the subconscious self is helped by stereotypes. The stereotypes are energy-saving devices that allow man to make efficient decisions on the basis of past experience, help to quickly process new information and retrieve memories, make sense of real differences between groups, and predict, often with considerable accuracy, how others will behave or how they will think.<sup>217</sup> Stereotypes and the information they give helps man to avoid danger, approach possible new friends, choose one school or one job over the other or to identify that person who may be the love of his life.

It matters how close a stereotype is to the self-image. Man feels stronger identity and empathy with other persons the closer his stereotype of them is to his self-image. Evolutionary traits, such as ‘Inclusive Fitness’, contributes to his identifying himself strongly with those with whom he shares genes.

Automatic, stereotyped behaviour is often the most efficient form of behaviour<sup>218</sup> or simply necessary<sup>219</sup>. That is, as Tavis and Aronson point out,<sup>220</sup> the upside. The downside is that the stereotypes flatten out differences within a category and exaggerate differences between them. Studies have shown that man attaches very positive sentiments to the words us, we and ours, while being more restrictive when it comes to them, they or theirs. ‘Boys are crybabies’, a girl complained to her mother when coming home from her first day in kindergarten after seeing two boys cry. ‘Did no girls cry?’ her mother, who happened to be a social psychologist, asked. ‘Oh, yes,’ her daughter said. ‘But only some girls cry. I didn’t cry.’<sup>221</sup>

‘The contrast between the ‘we and the ‘they’, the common fight against those outside the group, seems to be an essential ingredient in any creed which will solidly knit together a group for common action’, Hayek notes.<sup>222</sup>

A negative side of stereotypes is thus that they create prejudices. Such prejudices can be possible to diminish: when the economic competition subsides, when a truce is signed, when the profession is integrated, when they become more familiar, when ‘we’ are in a position to realize that they aren’t so different from ‘us’. Exposure can affect the subconscious beliefs and thus also the stereotypes. If you are white and get to know a black man and start to realize how much alike you are, your stereotype of black men will be affected. People who regularly

---

<sup>216</sup> Dahlsten, 2011, pp 49-50

<sup>217</sup> vgl. Macrae, Milne and Bodenhausen, 1994, pp 37-47

<sup>218</sup> See Gigerenzer and Goldstein, 1996, p 650-669

<sup>219</sup> See Bodenhausen, Macrae and Sherman, 1999, pp 271-290

<sup>220</sup> vgl. Tavis and Aronson, 2008, pp 57-67

<sup>221</sup> Tavis and Aronson, 2008, p

<sup>222</sup> Hayek, 1944, p 143

meet people from other nations, other religions or who are ethnically different are less likely to have prejudices than those that are living only among people who are like themselves. Cognitive dissonances are not always solved; the self-justification process may just manage to explain them away. In some cases, as when it comes to stereotypes, they are kept, partly because the stereotypes are needed. When the dissonance occasionally is brought into the open it will be up to the conscious self to override the emotions the subconscious has created.

Prejudices are very difficult to eradicate for the simple reason that the stereotypes are needed to make quick decisions. In fact, there are limits to how broadly we can develop trust with other people. Fukuyama has found that societies with strong family-centric values, while having deep bonds of trust within families, tend to have narrower radii of trust outside families.<sup>223</sup> This limits the economic networks. As examples Fukuyama cites the large proportion of small-scale, family-owned businesses in China, Korea and Italy and the low number of global enterprises relative the size of their economies in comparison with e.g. Holland with another culture. Karla Hoff of the World Bank and Arijt Sen of the Indian Statistical Institute believe that overly strong family ties can have a negative impact on development, as extended definitions of family create incentives for free riding and low returns to work and savings.<sup>224</sup>

There are some well-known cases (such as Al Campanis, Mel Gibson) when a famous person has slipped into prejudicial comments under the influence of the situation or alcohol. Many claim the circumstances exposed their true views and that there are no excuses. Mel Gibson's stereotype of a Jew was most likely influenced by his father who was a well-known anti-Semite and denier of Holocaust. For Al Campanis the incident led to public disgrace and a personal tragedy. Contemporary research shows that people perhaps should not have been so quick to criticize. The brain works in quite a complicated way. Most, or more correctly all, have stereotypes in the subconscious, many of which the conscious self may find prejudicial if aware of them. An individual may have stored rejections of those prejudices in the memory, but as they are based on reasoning they are accessible only to the conscious selves. If someone is drunk or under stress conscious beliefs may not be accessible as drugs and fear can more or less close down the reasoning conscious self. Left only with subconscious stereotypes anyone may act in a way he would not do under normal circumstances.

The fact that the subconscious can hold prejudicial views unknown to the conscious self has been politically utilized. Westen has shown how political candidates have in a subtle way exploited racial prejudice in their campaigning. By using words that do not stir the conscious selves but alert the subconscious they have been able to create feelings of unease with the alternative candidate. The remedy to such practices is according to Westen to uncover them, to make the underlying message visible.<sup>225</sup> The logic behind his advice is simple: Much fewer conscious than subconscious beliefs are prejudicial beliefs."<sup>226</sup>

---

<sup>223</sup> vgl. Fukuyama, 1995, pp 62-145 quoted by vgl. Beinhocker, 2006 p 434.

<sup>224</sup> vgl. Hoff and Sen, 2001, quoted by vgl. Beinhocker, 2006 p 434

<sup>225</sup> vgl. Westen, 2007, p 223

<sup>226</sup> Dahlsten, 2011, pp 21-23, a developed version of Dahlsten, 2010, pp 31-33

## **No global community**

We need our stereotypes, and we automatically identify ourselves with people that are like us. This makes the development of a global society with common values a highly unlikely if not impossible proposition.

The social psychologists Carole Tavris and Elliot Aronson “have shown in their research how consensus cultures can develop in a group to protect the collective ‘thymos’ and create unwillingness from a group to face new facts and to reason logically. They have shown how child psychologists, who dealt with incest cases during the 80’s, as a group refused to face the fact that their therapeutic methods may have induced false memories in the children; many prosecutors and judges as a group have in a similar way rejected new DNA evidences that have shown that they have convicted the wrong person by coercing false confessions. The Founding fathers of the US Constitution had an intuitive understanding of this effect and therefore tried to build in a number of checks and balances in the governance in order to avoid such consensus cultures to develop.”<sup>227</sup>

Group conformity is strengthened by the way we learn. Imitation is one way in which man learns, especially during his first years. The ecological inheritance is often a result of imitation. But the influence of people around the individual does not stop there. When he is uncertain he looks at what others do.

“Cialdini<sup>228</sup> has gathered a number of examples of how we can be unduly influenced. In the 1950’s a social psychologist Solomon Asch tried to understand why Germans went along with the Nazis. He made an experiment in which people were asked to compare the length of one line with three other lines and tell which one that was closest in length. The task was extremely simple and the six answered quickly and correctly several times all of them. But then something happened. Five of them gave suddenly a wrong answer (which they were told to do as part of the experiment). When faced with this dissonance the sixth person answered wrongly one third of the times, although he did not know any of the other participants or was likely to meet them again. In a similar experiment performed by another researcher people were asked to consider this statement: “Free speech being a privilege rather than a right, it is proper for a society to suspend free speech when it feels threatened”. Asked the question individually only 19 per cent of a control group agreed, but being confronted with a yes from four other participants 58 per cent agreed. Group conformity is a strong motivator.”<sup>229</sup>

Sales people know that group dynamics works even better if the “group” consists of people who are like the targeted object for the sales and thus uses references to friends or other of the object’s “stereotype” as social proofs to influence him. Likewise - when people around do not react nor do we. Group dynamics seem to soften personal responsibility. Studies show that a

---

<sup>227</sup> Dahlsten, 2010, p 54

<sup>228</sup> See Cialdini, 2001

<sup>229</sup> vgl. Thaler-Sunstein, 2008, pp 55-65



victim to an accident or crime is far more likely to be helped by a single bystander than if passed by hundreds of people.<sup>230</sup>

People prefer to say yes to individuals they like. Psychologists have identified a number of factors that are important: Physical attractiveness, similarity, praise, familiarity, and association.<sup>231</sup> It should be noted that three of those, similarity, familiarity and association, respond to man's stereotyping. The more we can identify ourselves with the individual in question the more likely we are to have a positive opinion of him or her. That man responds to praise is natural as it confirms that he is recognized. That he responds to physical attractiveness is likewise not very surprising and most probably linked to reproductive success.<sup>232</sup>

“Contemporary research also seems to indicate that we have a tendency to overestimate the role of the genetic inheritance and underestimate the importance of the ecological inheritance. This has in my understanding to do with how we remember. The subconscious memories are functioning as a running tally; they are updated with new experiences and knowledge, but we do not remember why we have come to have the beliefs we have. They all form an intrinsic knowledge about life and the fact that most of this knowledge is acquired is not something we are aware of.”<sup>233</sup>

“The subconsciously stored knowledge relates to our immediate situation and the relations to others such as our parents, friends etc., but it has also a considerable component of knowledge around the relations to the collective other.<sup>234</sup> An important part of that knowledge constitutes what is sometimes called common sense. It is a concept that summarizes our internalization of cultural and ecological prescriptions on how to respond in different situations to external stimulus and to changing environmental conditions. The development of a common sense is part of our socialization process. What is common sense in Texas is, however, not necessarily what is common sense in Tokyo or Islamabad. The cultural conditions in which we are brought up have thus a major impact on how we act when on ‘autopilot’.”<sup>235</sup>

Rodrik warns: ‘A strong sense of global citizenship tends to be confined, where it exists, to wealthy individuals and those with the highest levels of educational attainment. Conversely, attachment to the nation-state is generally much stronger (and global identities correspondingly weaker) among individuals from lower social classes. The cleavage is perhaps not surprising. Skilled professionals and investors can benefit from global opportunities wherever they may arise. The nation-state and what it does matters a lot less to these people than it does to less mobile workers and others with fewer skills who have to make do with what's nearby. This opportunity gap reveals a certain dark side to the clamour

---

<sup>230</sup> See e.g. Latané and Darley, 1968

<sup>231</sup> vgl. Cialdini, 2001, p 176

<sup>232</sup> Dahlsten, 2010, pp 34-35 and Dahlsten, 2011, pp 25-26

<sup>233</sup> Dahlsten, 2011, p 42-43

<sup>234</sup> About human awareness in a societal context see Markova, 1987, ch. 7.

<sup>235</sup> Dahlsten, 2011, p 50-51

for global governance. The construction of transnational political communities is a project of globalized elites attuned largely to their needs.<sup>236</sup>

### **No common value base**

“It is not only the evolvment of a global society based on a global feeling of togetherness that is an unlikely proposition, so is the idea of a common value base.

“There is little, if any, evidence supporting the perception that values should be genetically inherited. While evolutionary biologists claim that we are born with features that support survival and reproductive success - among them core “family values” such as “inclusive fitness” that strongly attaches us to those with whom we share genes - there is no evidence that more general values such as the equality of men, fairness and honesty are to be found in the genes. The finding offsets the idea that man is born with the innate moral value that we are all equals.”<sup>237</sup>

The values we hold consciously also differ from those that are supported by the subconscious processes. They are acquired in different ways - the conscious self through processes of reasoning and the subconscious mainly through internalizing. The internalizing can be of values that first are held consciously. The subconscious self of a child internalizes values by imitating, by being rewarded and punished. Values are taught by parents; they can be part of an ecological inheritance such as the language; languages emphasize different values; they can be strengthened by the culture of a local community or be a national heritage.

The conscious reasoning self may have learned additional values, such as the equality of man, but their internalization of such values in the subconscious is not as easy as it may seem. One reason is that the subconscious is dependent on stereotypes for its ‘shortcutting’. The stereotypes tell the subconscious how it can expect other people or groups of people to be, and such perceptions can often be quite prejudicial. Ethical values such as tolerance and empathy with people who are different have an uphill struggle to be internalized.

The consequence is that the set of values that we apply when reasoning consciously to a certain extent differ from those set of values that we apply when doing our subconscious ‘shortcutting’.

The stereotypes that the subconscious selves are using when ‘short-cutting’ are thus culture-sensitive, as are the values we internalize. The fact that we as collectives are so strongly affected by our ecological inheritance puts limits on how far we can hope to come in issues around global governance. A shared value-base cannot be taken for granted. It also explains why people in general want social conditions to be decided as close to them as possible and within their own cultural framework.”<sup>238</sup>

---

<sup>236</sup> Rodrik, 2011, p 231

<sup>237</sup> Dahlsten, 2010, p 52

<sup>238</sup> Dahlsten, 2011, p 50-51

## Democracy is a vulnerable concept

Our tendency to form groups and strong national identities are two main reasons why a global government that would replace the role of the nation-states will remain an un-implementable vision. Another reason why the idea of a democratic global government is likely to go nowhere is that democracy as a concept is extremely vulnerable given the nature of man, and that it needs a steady nurturing and almost ideal preconditions to work well.

Democracy has always been a debated system of governance. It is, as Held draws attention to, not until the last decades that democracy has become the norm and rulers have strived to portray their regimes as 'democratic' regardless of the real situation. The progress of democracy has been far from linear and it is difficult to track the advancement of a coherent philosophy. The Athenian democracy was constantly questioned, not so much for its exclusion of the slaves or the women, but for its lack of legitimacy and efficiency. "The Scandinavian countries had an early form of direct democracy, but there is no known link between the Scandinavian 'ting' democracy and the Athenian version. Neither is there any 'ideological' link between those early democracies and the post-medieval development of democracy in the Western world. Held sees the latter development rather as a response to the challenges and opportunities that the nation-states were facing at the time.<sup>239</sup> The rulers had to mobilize military resources and capital in order to finance colonial expeditions and benefit from raw materials and goods to low costs. To achieve their objectives the rulers needed the consent of their people and in order to get that they offered them participation in the governance of the states. The notion of public consent was central also to John Locke as he developed the Kantian and Rousseauian idea of a social contract between a ruler and the people, the 'demos'. "<sup>240</sup>

"Democracy is on the surface placing few demands on the citizen; he is not expected to make decisions every minute of the day. Democracy is not primarily aimed at fulfilling individual desires; it is supposed to be a value-based system that recognizes the equal value of man and ideally leads to collective rational solutions to collective issues. Once in a while people have to take a stance, vote in an election or take part in a referendum. It may seem that they are given ample time to make the choices, all the time they may need to reason deductively and reach considered decisions."<sup>241</sup> In practice it does not work that way. Subconscious processes play a strong role also when we act as citizens in a democracy.

In order to thrive, democracy needs an environment that supports the development and maintenance of shared values and a rational reasoning based on shared knowledge; such conditions are difficult to create given the nature of man. Political attitudes and values are internalized together with other values early in life and they create what is sometimes called symbolic preconditions. Those preconditions can form a confirmation bias that blocks rational

---

<sup>239</sup> vgl. Held, 1995, p 60 ff.

<sup>240</sup> Dahlsten 2010, pp 90 - 91

<sup>241</sup> Dahlsten, 2010, p 55, Dahlsten, 2011, p 51-52

reasoning. With restricted or ‘blocked’ knowledge the ‘power’ of an individual’s conscious self over the subconscious diminishes.

The idea of reasoned beliefs that is central to democracy also demands a media environment reasonably free from intimidation and manipulation and it demands active efforts to spread and share un-biased knowledge and values. Contemporary research has shown how people can be subtly manipulated. The knowledge gained around mechanisms such as anchoring and priming or the exploiting of group conformity and psychological reactance are not lost on politicians who want to win elections or companies who want to sell products or services. Whether a person is in fear or in a happy mood also affects his reasoning. This increased understanding of how to manipulate people is a challenge to democracy, especially as the knowledge gap between the informed elite and a less informed population seems to be increasing in many countries. The risk that the research results will be used to benefit the interests of the privileged few by manipulation of the ordinary citizens is obvious. Tendencies in that direction are noticeable, especially in countries where media are owned by individuals with political ambitions.

An area in which important research is still on-going is the effect moods have on how the mind works. Whether a person is in fear or in a happy mood clearly affects his reasoning. The mood creates a form of bias. The research of the psychologist Drew Westen<sup>242</sup> indicates that a subconscious self in fear can initiate decisions based on faulty premises such as subconscious prejudices, before the reasoning conscious self is alerted. The process under which people in Europe and the US gave up much of their privacy during the recent ‘reign of fear’ can serve as an example. Most people realize how power can be abused, if a state has full and unrestricted surveillance of its citizens, when reflecting rationally about the issue. At the same time the perceived increased security makes them ‘feel good’ and less afraid.

### **The UN is no alternative**

Many who are engaged in the idea of a future global government see the UN as an instrument to create the vision. By strengthening the UN they hope to create the preconditions for democratic global governance. Held among others argues in favour of a new global order that recognizes the need of separate bodies with different geographic reaches acting in parallel.<sup>243</sup>

Besides the fact that the end goal is an impossible dream, the road is filled with too many blocks.

The creation of the United Nations was negotiated more or less in parallel with the negotiations that created the IMF, the GATT and the World Bank. It was no easy ride and progress demanded sometimes that the US used the language of the victor. To reach consensus the UN was built upon two principles, none of which is applicable for the

---

<sup>242</sup> See Westen, 2007

<sup>243</sup> vgl. Held, 1995, p 219 ff

governance of the global market economy. The Security Council reflects the military realities and the General Assembly gives each country one vote. In the Security Council there are veto rights and in the Assembly (and other UN organization) there is a demand for unanimity if any resolutions are to be binding. The UN plays an important role in the areas for which it has been created, but none of the decision conditions would be workable if efficient and timely governance of the global market economy is to be achieved. The UN-led negotiations on Climate Change show the short-comings of the UN model. Following the disappointing result of the UN climate negotiations in Copenhagen renewed calls have been made by international think-tanks<sup>244</sup> for a new global world order, but the expectations of advancement are generally low.

## VII. THE JUSTIFICATION OF WORLD MARKET GOVERNANCE

The need of proper governance of the global market economy should be seen in the light of a dramatic development of the world economy in which actions of individuals, companies and states all around the world have become increasingly intertwined. The market economy as a concept has gained support around the world; the alternatives that have been tested have failed to deliver outcomes in line with people's expectations. This acceptance, together with the aspirations of the populations in the emerging and developing countries, the surfacing of a global financial market, and the development of information technologies that enables supply-chains to cover the globe, have contributed to a globalisation that has created a truly global market economy. The globalisation process is, if anything, gaining speed and involving more and more countries. While globalisation is offering many benefits it is at the same time undermining the authority of the public order. The global market economy has outgrown the territoriality of the public order and the market economy can no longer be controlled by the individual states. The marriage between nation-states and the market economy, which has created liberal democracies, is facing a difficult period due to the increasing mismatch between the partners' territorial reach. The finances of the nation-states are undermined as wealthy citizens and global companies, especially the financial actors, are exploiting the possibilities of regulatory arbitrage.

The existing basically inter-governmental governance that was created in the post-WWII world has as a purpose to attend to issues related to the market economy, which cannot be properly addressed by the individual states. The functional global networks have more and more become able to address many practical questions but are unable to solve conflicts between the interests of the functional actors and the common interest. As the globalisation has progressed, it has been increasingly difficult to reach conclusive decisions through the inter-governmental order. The governance model has become insufficient in meeting the challenges that the rising global market economy offers. The scope is too limited and the way to reach decisions too cumbersome, there is a lack of authority, lack of transparency, and lack

---

<sup>244</sup> E.g. by the Tällberg Foundation.

of accountability. The implementation of often unsatisfactory compromises is patchy and inconsistent. The proposals to strengthen the order that the British Prime Minister David Cameron has tabled on the request of the Group of 20 are incremental and not likely to change the unsatisfactory situation. Cameron highlights the importance of political will; the underlying problem is that the politicians are held responsible by their national constituencies, while the challenges they are facing are global.

Two alternatives to the present insufficient governance have been favoured by the Political Left. One is a de-globalisation followed by a re-nationalisation of decisions concerning the market economy. The economist Dani Rodrik has developed ideas on how a reduced globalisation, or ‘sound globalisation’, as he calls it, could look like. In my analysis I have concluded that his alternative is unstable. It can lead to a return to the disastrous protectionist ways that deepened the Great Depression following the latest globalisation period, it can lead to the exploitation of developing countries by militarily strong countries, or it can simply fail.

The other favoured alternative of the Political Left is a global government, which is understood to be democratic. The development of a global public space and the strengthening of the UN are often seen as stepping stones on the route towards the ultimate goal. The weakness of the alternative is that it expects the global government to take over many of the social and cultural responsibilities that the nation-states have taken on as part of the marriage between market liberalism and the nation-states. I have tried to show that such a globalisation of the social conditions is unsupported by human nature and that this is the main reason and not the resistance expressed by the financial elite, why the alternative has no future. There is a World Society and an increasingly global market economy, but there is no feeling among people around the world of a global community. On the contrary, when the external pressure declines people want to see a break-down of ‘constructed’ states into natural nation-states with coherent cultures. It has happened in Czechoslovakia, it is discussed in Belgium, Spain and the UK.

The favourite alternative of many in the Political Right has historically been self-regulation, and the belief system on which it is founded seems to gather an increasing number of followers in the US. The idea is that the economy left to its own will produce a result that benefits everyone. The global market economy is facing problems, but they are according to the believers not due to too weak regulation, but to too much regulation. The economic theory on which this alternative is built has as its underlying assumption that man is rational. The ‘invisible hand’ and the ‘trickle-down’ that are part and parcel of the theory stands and falls with this perception. The Rational Choice Theory, which is the intermediary between this simplified idea of man and the economic science, is giving reasonably good predictions for the real economy in normal times, but it fails to predict the performance of the financial markets and has given unreliable forecasts for the real economy in times of turmoil. The reason is that The Rational Man theory is a too simplified understanding of man, and that especially the day traders on the financial markets are acting more on basis of their subconscious on-line reasoning capabilities than their conscious reasoning. The debate has shown that to counter the idea of self-regulation it is not enough to point to all the cases in

which the market has responded irrationally; economists need to discuss the underlying assumptions.

### **The purpose of the World Market Governance**

There is a growing feeling among both economists and politicians that something more needs to be done to govern the global market economy properly, but few are happy with the alternatives on the table. The real challenge is not only how to keep, but furthermore how to strengthen the states and federation of states, while creating a governance of the global economy that is effective.

The purpose of the World Market Governance (WMG) that I will introduce is thus to

- create a separate, effective, comprehensive and transparent governance structure for the global market economy,
- strengthen states and federation of states in their abilities to develop social and cultural conditions in each country in line with the aspirations of their citizens

I will first develop the reasons why the global market economy can be seen as a separate, societal system although intertwined with the nation-states and then why the nation-states at the same time are important fundamental societal systems that need strengthening. The WMG also needs the backing of a broad and sustained demand, which is something I will come back to.

### **The global market economy – a separate fundamental societal system**

To answer the question whether the global market economy is a ‘Justified Fundamental Societal System’ as defined earlier the following criteria have to be considered: Is the system central to the life, health, liberty and property of the people living within its reach? Has the individual little direct influence on the system? Is there an opt-out? Is there a defined reach? And finally - does the system have coercive powers?

For their outcome most people are relying on the market. Already the early liberal philosophers recognized that the market economy is an efficient way of meeting man’s desires. Desires are just like internalized values engraved in the subconscious; they are essential for survival and the meeting of almost all evolutionary drivers, especially Reproductive Success, and Inclusive Fitness; they are stretched in scope as people are experiencing more and more products and services to long for. Market economy is in contrast to the nation-state a societal system in which the individual can have variable and evolved desires met every day and in which he is a constantly present main actor. He has little

influence over the system as such but the system allows him large space to act, regardless whether the actions are based on conscious value-based reasoning or on subconscious processes driven by desires and values of which the conscious self even may be unaware.

The market economy is also the perfect scene for gaining recognition, for ‘thymos’. The market is an arena in which man, in order to gain recognition, has the right to compete and be superior, even be admired for it. Every man is seen as unique and in an ideal situation any man can live his dream. He can get recognition in a democratic system too, but in principle only if he competes for public office.<sup>245</sup>

“I will come back to the value aspects when I discuss the question of legitimacy, but it is clear that the market economy, in another way than the state, meets the first criteria of a societal system. It is central to the life, health and property of individuals within its reach.

Man can act quite freely within the market economy. If he has economic power he can also influence the way the system works; he can dominate a local market, create geographical monopolies, price cartels etc. While the system can be used or misused, the way it is built is less easy for most individuals to influence, at least not directly or on their own. Most individuals have little, if any, direct influence of the functioning of the market economy system as such.”<sup>246</sup>

The third question is if there is an opt-out from the market economy, and the answer is that there is no real opt-out. “Anyone can in theory live isolated from the market - there are after all those living and surviving in jungles or in swamps - but man cannot without help meet more than very basic needs outside the market. While a nation-state in theory could intervene and support those opting-out from the market economy most states, if not all, are demanding the individual to try to find ways of supporting himself on the market.

The territoriality of the market economy has increased rapidly. As a system it is much more widely spread than democracy. 153 countries are when this is written recognized market economies and members of the World Trade Organization and 30 more are observers who are negotiating membership. Globalization is enabling work-sharing, distributed production and trading, a strong motivator for countries who have less developed economies to become full-blown members of the global market economy.”<sup>247</sup>

“The nation-state is, as noted, de jure the only one who can inflict harm (in the form of punishments) or refer such rights to another body without risking retaliation. The next question is whether the nation-state also has a de facto monopoly. It has already been described how the nation-state has granted legislative and judiciary powers through law and treaties to other levels. The global market economy has not been granted any such rights. Can the system as such still inflict harm without the risk of retaliation?

---

<sup>245</sup> vgl. Dahlsten, 2010, p 65

<sup>246</sup> Dahlsten, 2010, p 65

<sup>247</sup> Dahlsten, 2010, p 65



The answer to that question is in my opinion in the affirmative. An example of how harm can be inflicted without risk of retaliation is the present financial crisis. Numerous people have lost their properties, their homes, their pensions, and their savings capital without being aware of having taken any risks. It can be claimed that they can sue those that have “cheated” them and some will certainly try to do that. But the truth is that the abuse has happened as a consequence of a series of decisions in a system over which neither they nor the state has a de facto control. Who is to blame? The real estate agents who inflated the values of homes, knowing that they could fix higher mortgages than even those inflated values, the brokers that arranged the loans, the home-buyers that accepted them without having any possibility to pay back, the financial institutions that split up the loans in pieces and sold them off as structured products, the rating institutes that put triple A’s on the products, with the small print that the rating was based on ‘historic performance’, the institutions that bought the products without reading the small print and who used the products to secure the savings and the pensions? Or should the Federal Reserve be blamed, which boosted the US economy with low interest rates at the same time as the Congress stimulated it with a huge financial deficit? Or the Chinese that let their economy slip into a dangerous dependency on export? Or the young guys of Harvard and Yale who got hundreds of millions in bonuses and who invented the ‘structured’ products in the first place? Or the ‘fools’ who should have put their money in the mattresses instead of buying into the schemes?

Clearly, ‘the fools’ are not the ones to be blamed. The market economy would not function if money were kept in mattresses and not put to work. And it is hard to lay the responsibility firmly on anyone else. The harm done is mainly due to a systemic failure, seldom the result of single actions in bad faith. Such have been identified, and some of them are and will lead to prosecutions or litigations. But they concern less than one per cent of the losses that have occurred.

Is then not the state to blame? Is not the state, to use the language from the Lord of the Rings, the Ring to Control Them All? Theoretically and de jure, it is correct.<sup>248</sup> But there is a significant objection to that conclusion. While the nation-states have geographical borders the market economy knows no such barriers. “The chain described above may have started in a small city in Oklahoma but have ended up in lost savings for an Italian shopkeeper, lost pensions for a Swedish plumber and unemployment for a Chinese worker in a textile factory.<sup>249,250</sup>

It is, as I have discussed before, not only the political and economic systems that have power as one of their success media, to use the language of Luhmann. This is the case for many systems to which the political system ‘delegates’ power. The power a teacher exercises in relation to their pupils is such a power. Sport associations and churches can also exercise power over their members, but then it is part of an accepted communication of rules between the hierarchy and the members. The market economy system was restricted and guided by the

---

<sup>248</sup> Dahlsten, 2010, pp 67-68

<sup>249</sup> That the market economy as a system can inflict harm is recognized by Habermas, 2011.

<sup>250</sup> Dahlsten, 2010, p 68

political system in its exercise of power as long as the system was mainly national. The aspect that makes it a fundamental societal system in my definition is that it is increasingly independent of the national political systems. The issue is that there is no proper global governance to control the power.

To conclude: The global market economy meets the criteria of a justified fundamental societal system. 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 that independent of the political system.<sup>251</sup>

### **The indispensable nation-states**

Proper global market governance is needed that ensures financial stability, well-functioning global markets and a level playing field, but also allows nation-states to have their own social systems and make their own decisions on issues such as re-distribution of wealth.

The minimal state, in favour of which Locke and Nozick argued, meets people's need for security, liberty and justice in a very formal sense. The liberty the state offers gives the individual the right and possibility to freely search his outcome on the market, to make contracts with whom he likes, to produce, acquire and sell goods, services and property. The modern welfare states have become more than guardians of those basic rights. They have expanded the Lockean value-base to include equality, which also has given the concept security a broader meaning. Welfare states are offering support if you are taken ill, when you are too old to take care of yourself or vulnerable in other ways; they support education and other human need. There is a clear link between social programs, such as education, health care, pensions, and employment policies, and the expectations on the nation-states.

The wish to protect and develop the social conditions within a culturally coherent group seems to be anchored in human nature. The way the subconscious works, creates a 'ranking' between our different identities; the ability to identify with other people depends on how far away they are from us genetically and culturally. The globalisation process is in general met with both apprehension and scepticism; people embrace new cheap products at the same time as they are afraid of losing their jobs and some of the comfort of 'belonging'. Companies have identified this complexity in the well-known 'glocal' strategy and although many would argue in favour of 'fair' social conditions all around the world there is reluctance from citizens to allow decision-makers, who are too far away from them, to have a final say on issues that concern their social conditions, such as education, health, pensions etc. The tendency is rather that people want to see such decisions to be anchored even more locally, driving decentralization in Spain and the possible 'break-up' of Belgium.

---

<sup>251</sup> vgl. Dahlsten, 2010, p 68

The role of nation-states is of course affected by the emergence of the global market economy as a separate societal system. The nation-states<sup>252</sup> will remain as the constitutional level for the foreseeable future and they will continue to have an important role to set the rules for the civil society in accordance with the national culture and habits. But it is, as has been described, increasingly difficult for them to impose unilateral rules for the functioning of the market economy. Even their role as implementers of globally agreed standards and regulations are under pressure. Just one of many possible examples: The UK government has recently quite openly been challenged by the financial actors in the City to withdraw plans to implement more strict financial regulations, especially rules for capital requirements. If not, the consequence may be, they claim, that they move to a place with more relaxed regulations.

A severe problem for the Western hemisphere is that the financial status of the nation-states has deteriorated as they during the latest financial crisis in many cases have been forced to socialize debts originating from banks and households. They are in addition often burdened by a trade deficit. Their financial standing is not seldom undermined even further by the fact that governments have found it increasingly difficult to tax its global companies and rich citizens, who with the deregulated financial markets have no difficulties to vote with their feet and to move their profits and wealth. Many countries are in practice restricted to a redistribution of wealth between the more well-off 'ordinary' citizens and the less well-off; their possibilities to finance the social programs asked for by their citizens have been undermined. In short, they are looking forward to a troubling future.

How to strengthen the states and the federation of states and ensure their sovereignty is a question that has to be addressed sooner rather than later.

### The need for social institutions

Many researchers have highlighted that the market economy to develop its full wealth creation potential needs functioning social institutions such as a developed rule of law. It will be an important objective for nation-states, the European Union and other public orders to also in the future ensure the effectiveness and independence of such institutions, but it is more than a formal task. The political scientists Bo Rothstein and Johannes Lindvall have in a book *Roads to Welfare*<sup>253</sup> (my translation) shown how dependent the effectiveness of the institutions is on the national situation.<sup>254</sup> They note that there is little evidence that democracy in itself is enough to create conditions that, for example, will lead to less corruption. It is sadly on the contrary the case that countries that have new-born democracies often become more corrupt after the introduction of democracy; it is only countries with a long democratic tradition that in general have a low level of corruption.<sup>255</sup> What they show is

---

<sup>252</sup> I continue with the simplified description of the public order. The nation-state may have delegated some of its functions to regions and communes; it may have entered a federation or a union such as the European Union and transferred some its decision power to the federation or the union. Such conditions do not change the principle arguments.

<sup>253</sup> See Lindvall and Rothstein, 2010.

<sup>254</sup> vgl. Dahlsten, 2010, pp 65-66

<sup>255</sup> vgl. Lindvall and Rothstein, 2010, p 37

that it is not enough to build institutions; you also need to focus on the building of shared values and of trust, in short the development of the social capital. Michel Foucault has introduced the notion of governmentality in which he combines government, rationality and mentality. It is a concept that highlights the interconnectivity between the formal structure of governance and the social and cultural environment.<sup>256</sup>

The Commission on Growth and Development, with members from the donor community, sees the social capital issue as being as central as the institutions. With social capital they mean the extent to which people feel that other people can be trusted and how many contacts they have outside their close family group and with people of other ethnic background.<sup>257</sup>

How important trust is in a society is shown by the success of countries where there is such a social capital. According to the World Value Survey about 60 per cent of the population in the Nordic countries feel that you in general can trust other people. In continental Europe the figure is 40 per cent, in Southern Europe 25 per cent and in countries such as Brazil, Romania, and Turkey around 10 per cent.<sup>258</sup> There is a clear correlation between the level of trust in a society and economic success. Where there is no trust there is corruption. If you do not trust others to play by the rule, you do not do it yourself. In countries in which the market actors are powerful there may also develop a legal corruption; the World Bank economist Daniel Kaufmann invented this term to describe the influence of powerful financial actors on the lack of regulation in the up-running of the latest financial crisis.<sup>259</sup>

The nation-states will continue to have a central role in the building of social capital. The Argentinean scholar Mariano Grondona has proposed three broad categories of cultural rules that build social capital and support economic development.<sup>260</sup>

In the first category are norms related to individual behaviour. These include norms that support a strong work ethic, individual accountability, and a belief that you are the protagonist of your own life and not at the whim of gods or Big Men. Economically successful cultures appear to strike a balance between optimism that improvement is possible, and realism about one's current situation. In the second category are norms related to cooperative behaviour. Foremost is a belief that life is a non-zero sum game and that there are payoffs to cooperation. It is important that the culture includes norms that value generosity and fairness, but also sanction those who free ride and cheat. The third category contains norms related to innovation. Cultures that look to rational scientific explanations of the world rather than religious or magical explanations tend to be more innovative. The culture needs to be supportive of competition and celebrate achievement, since overly egalitarian cultures reduce the incentives for risk taking. Finally, cultures that live for today (or, conversely, are mired in

---

<sup>256</sup> vgl. Dryzek and Dunleavy, 2009, p 294

<sup>257</sup> vgl. Lindvall and Rothstein, 2009, p 40

<sup>258</sup> vgl. Lindvall and Rothstein, 2009, p 42

<sup>259</sup> vgl. Kaufmann, 2008

<sup>260</sup> vgl. Harrison and Huntington, 2000, pp 44-55, quoted by vgl. Beinhocker, 2006.

the past) have problems across the board, ranging from low work ethic; to an inability to engage in the future.

### Countries, not only companies, compete

The states and federation of states play an important role in the market economy. There are issues concerning the market economy and the way it functions locally and nationally, which can be successfully regulated by a state, protection of competition and consumers on domestic markets e.g.

A perhaps even more crucial aspect is that countries, not only companies, compete. The nation-states compete through creating a business climate that supports competitiveness; they compete with education, research support and innovation-friendly policies. The role of the nation-states in the process of generating businesses is recognized in the WTO negotiations and a line in the sand has been drawn. It is accepted that the interests of the nation-states and the business community are intertwined until the point where a company has produced the first commercial series – as long as the company is not overcompensated. After this line in the sand the company is on its own and has to abide by the international rules for trade.

This line in the sand is a natural starting point for the division of labour between the governance of the global economy and that of a nation-state. How the interaction between the two levels plays out is crucially important. The global governance needs not only to create the right conditions in order to stabilize and develop the global economy; it also needs to create the right conditions for the nation-states to fulfil their important roles.

Rodrik is in his argumentation for a re-nationalization highlighting this role of the nation-states. Some of the space for actions he wants to create would come in conflict with free trade and open markets, but many are possible to develop within the existing framework. Industrial policy may be an ugly word for many believers in the Washington Consensus, but the truth is that their home country is the world-leading nation in industrial policy, far ahead of the European Union for example. The US historic successes in innovation are especially linked to the advanced American pre-commercial procurement programs. The US Defence has identified its long-term needs and has challenged the market to come up with solutions. The famous Darpa program under the Department of Defense can proudly claim an important role in the creation of supercomputers and internet, and of companies such as IBM, Microsoft and iRobot. Parallel programs in other ministries, such as the Departments of Energy and Health are filled with similar success stories. The US Congress has been active in other ways in creating excellent conditions for US companies. A success story of late is the saving of the American car industry. A message from Washington with the content “Do as we do, not as we say” would go a long way in creating a better global dialogue around the governance of the global market economy

## VIII. OBJECTIVES

The overall objective of the WMG is twofold: To create a long-term stable fitness environment for the global market economy and to strengthen the sovereignty of states and federation of states.

In the chapter on what we can learn from history I reminded that FA Hayek 1944 called upon “an international political authority which, without power to direct the different people what they must do, must be able to restrain them from action which will damage others. The powers which must dissolve on an international authority are not the new powers assumed by the states in recent times, but that minimum of powers of the ultra-liberal ‘laissez-faire’ state.”<sup>261</sup> For that purpose Hayek proposed a federation in which the Rule of Law was the centrepiece.

What would it mean if the objectives of the World Market Governance were to ensure an international order as proposed by Hayek? I have already discussed the tasks of a state with only market liberal objectives and concluded that there are few of these tasks that a nation-state (or the EU) can perform on its own in this new era of globalisation. We have reached the level of international interdependence that Hayek predicted and there is a need for global governance. We should, however, not stretch that governance further than necessary, as we also want to strengthen the national and regional levels and enable them to form social and cultural conditions in line with local and national preferences.

There are thus good reasons to let us be guided by the agenda of the market liberals and to define the objectives of the World Market Governance in line with the Hayek vision of an ultra-liberal global federation. The focus on the roles of states has changed slightly since Hayek developed his vision, especially when it comes to the necessity to take a joint responsibility for the global ecosystem and the objectives he had in mind have to be adjusted to that new reality. How such an adjusted agenda could look like has already been discussed in Chapter II and I use that discussion as a starting point for this more developed, but still tentative, proposal:

World Market Governance would thus have the following objectives:

- Regulation of the financial markets. The financial markets are global and the regulations invite regulatory arbitrage if they differ in scope and content. One important and urgent objective should be to stabilize the financial environment and get the market of ‘hot money’ under control. The financial markets are a cornerstone in the global market economy that needs proper regulation and oversight to work in an efficient way.
- Establishing and enforcing laws of contract. Contracts do not only have to be harmonized, they also need to be possible to enforce.

---

<sup>261</sup> Hayek, 1944, p 238

- Preventing overt coercion of individuals by others. Fraud and undue exploitation of ignorance must be possible to pursue.
- Rules for acquisition and sales of assets. More and more companies and investors are active across borders.
- A common foundation for the exploitation of natural resources. The countries in demand of commodities are often not the ones with the resources. Common rules would help to avoid unfair conditions.
- Harmonized competition rules and regulation of unavoidable monopolies. A level playing-field for companies and other market actors with as far as possible equal and predictable rules is important. The US and the EU already have different competition rules and, above all, they implement them in different ways. China is now about to set up a third similar competition authority that may come to another set of conclusions, making the life of international companies even more difficult.
- Recognition of Intellectual Property Rights. Harmonization work is under way, but there are many areas where the rules differ, and, specifically, patents and other protective measures that are recognized by one country are not automatically recognized by other countries.
- Free and fair trade. Free trade is the ultimate goal and multilateral trade agreements that balance the interests of different countries the fairest way to reach it.
- Basic labour and migration conditions. Fair markets demand that basic legal conditions are harmonized, and that in particular the access to labour and the basic labour conditions are agreed.
- Stable currency relations and global money supply. Countries need to cooperate within a common framework to control money supply, create stable currency relations and solve national default situations.
- Agreed ways of internalizing 'externalities', such as environmental impacts, into the market economy system. We have a joint responsibility for the world we are living in and have to address environmental and health challenges and future scarcity of commodities together. The most efficient way to take externalities such as pollution of air, water and soil, and other environmental issues such as climate change and deforestation into account is to ensure that the effects are internalized into the global market economy in a way that does not cause unfair conditions.
- Enable states and federation of 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 have to be shared with the many and the increase of the gap between the "have" and the "have-nots" be brought to a halt. A fair domiciliation of companies and citizens for taxation is one condition that is important to avoid some of the regulatory arbitrage that undermines the finances of nation-states.

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.

## IX. THE RULE OF LAW – A CENTREPIECE

Besides a more defined scope, what is it that the present inter-governmental order is lacking, and that World Market Governance could add? Hayek argued that the main short-coming of the inter-governmental order was the lack of Rule of Law To quote Hayek once again: “We must not deceive ourselves that in calling in the past the rules of international behaviour international law we were doing more than expressing a pious wish.”<sup>262</sup>

Lord Bingham of Cornhill<sup>263</sup> has in a famous speech developed his idea of the Rule of Law. It demands, he claims, that the law must be accessible and so far as possible intelligible, clear and predictable; questions of legal right and liability should ordinarily be resolved by application of the law and not the exercise of discretion; the laws of the land should apply equally to all, save to the extent that objective differences justify differentiation; the law must afford adequate protection of fundamental human rights; means must be provided for resolving, without prohibitive cost or inordinate delay, bona fide civil disputes which the parties themselves are unable to resolve; ministers and public officers at all levels must exercise the powers conferred on them reasonably, in good faith, for the purpose for which the powers were conferred and without exceeding the limits of such powers; adjudicative procedures provided by the state should be fair; the state must comply with its obligations in international law, the law which, whether deriving from treaty or international custom and practice, governs the conduct of nations.

This is a definition that contains a number of value statements about equality, reason and fairness. Such value propositions are usually found in constitutions, in legal code of conducts and in oaths taken by servants of the judiciary and of the courts. The objectives of the rule of law are, in the version of Lord Bingham of Cornhill, also made clear. Laws are created to support human rights, the well-functioning of the civil society and to uphold international obligations and should be implemented in a fair and reasonable way. The courts can apply laws that concern relations between the individual and the public; they can also take on cases that relate to the market economy to the extent that they are regulated by law or are referred to the courts by the parties concerned.

A Rule of Law as a pillar of World Market Governance would thus contain three elements.

- The first is an international legislator. The legislator must be accepted and respected.
- The second is a set of international laws. The laws have to be binding.
- The third is institutions that can implement and monitor.

---

<sup>262</sup> Hayek, 1944, p 239

<sup>263</sup> vgl. Lord Bingham of Cornhill, 2006



- The fourth is an independent judiciary. The laws must be interpreted and enforced in an impartial way.

The Rule of Law puts high demands on the legislator, and I will come back to how they can be met. The continental European tradition with unambiguous laws that do not allow the courts the space to take political or nationalistic decisions seems to be one way to ensure that the laws are respected and that the independence of the Judiciary is protected.

### **An independent Judiciary**

The standards for the Judiciary must be set high. The Rule of Law is a government of laws, not of men the US Supreme Court has stated several times<sup>264</sup>. The implicit meaning is that the Judiciary should be guided by reason, not by emotions. Neither should it be intimidated by man, by his power, his standing or his money. The Judiciary is expected to rise above prejudice and emotional constraints, to be guided only by facts and to play by the rules. This is a strong value proposition. The Rule of Law also resonates with another value, fairness, as people are expected to be treated alike. The Rule of Law also offers the ‘thymos’ an alternative to physical aggression, a peaceful way of problem solving. It is worth noticing that the definition that is used above strongly underlines those values: “{...} clear and predictable {...} application of the law and not the exercise of discretion {...} apply equally to all {...} exercise the powers {...} reasonably, in good faith”.

A crucial part of the WMG is thus a functioning Judiciary. Without such an independent body countries and companies may be drawn into backdoor negotiations and the legislations risk lacking teeth. A strong Judiciary ensures transparency and equal treatment. As the legislation would have a global reach and therefore be imposed on different levels, local and national courts would normally 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 or complaints by a company or an individual that is supported by a state. 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. To give the highest court a name I will henceforth call it the International Market Court.<sup>265</sup>

“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 must also be appointed in a transparent way, perhaps approved by the International Market Court.”<sup>266</sup>

To have a procedure for the recruitment and career development of the judges that is reasonably independent seems also to be important. If the appointment of judges is

---

<sup>264</sup> First stated by John Adams in draft to Massachusetts Constitution, 1780.

<sup>265</sup> vgl. Dahlsten, 2010, p 130

<sup>266</sup> Dahlsten, 2010, p 130

transparent and non-partisan it allows judges, who otherwise may feel that their job security or career chances are under threat, to follow the law and their conscience. But the independence must not go too far. A balance must be struck between the interest of checks and balances and the overall interest of coherent and accountable governance.

Real independence demands more than a separation of formal roles and transparent and non-partisan recruitment procedures. The courts must also be protected from intimidation. Courts can be swayed and have historically been swayed when put under pressure, both before and after Herodias asked the Publicus whom to spare.

Not only the independence but also the authority of the courts needs to be protected. Countries and companies must be obliged to implement and abide by the Court decisions and the consequences if they do not follow the Court decisions must be discouraging.

### **The Rule of Law meets most objectives**

Most of the objectives listed in the former section can be met by a clear application of the Rule of Law.

- The implementation of international regulation of the financial markets can be done mainly through national regulators. Their decisions can be challenged in the courts and if there are good reasons in the international courts.
- The enforcing of contracts that today sometimes is done through arbitration would be an obvious task for the national and international system of market courts.
- Frauds and undue exploitation of ignorance can be challenged in the market courts even when the alleged perpetrator is in another country.
- Common rules for acquisition and sales of assets can be enforced and suspected breaches prosecuted.
- The possibility for an international company to challenge a competition ruling in an international market court ensures equal treatment.
- An international legislation on Intellectual Property Rights and the possibility to raise complaints in a court would also support a level playing field.
- There is already a system through which complaints related to trade agreements can be brought to a judicial hearing, and the final decisions have so far been respected by all parties also by the US. This shows the strength of the Rule of Law.
- Basic labour and migration conditions. Fair markets demand that basic legal conditions are harmonized, and that in particular the access to labour and the basic labour conditions are agreed.
- Legislation on how to internalize "externalities", such as environmental impacts, into the market economy system can be enforced by national agencies and breaches be brought to the Judiciary.

### **International execution sometimes necessary**

Not all execution can be entrusted national agencies or judiciaries. There are some areas that demand international institutions and many such institutions are already created.

The WTO is one of those and it is the organization with the most experience of execution. Another is the IMF, the role of which has been expanded to cover issues around failing states as well as currency imbalances and global money supply. A developed IMF could become a lender of last resort and an international financial regulator.

The FSB and FSF have oversight over financial services regulations and standards and would have a natural preparatory role when it comes to international financial legislation.

The World Maritime Organization has taken an active role in the rules for exploration of the oceans, but there is no similar organisation for land-based exploitation of commodities. The International Energy Agency has e.g. no role in that respect. If legislation on the exploitation of natural resources was to be created there is thus a need to reflect upon the execution.

Another example: If a legislation on fair domiciliation of companies and citizens for taxation is to be created there is a need for some form of international authority. Not all disputes can be settled in court.

## X. LEGITIMACY

“Legitimacy lies in the eyes of the beholders and the perception of legitimacy has changed over time. Military conquest and domination has historically given rulers legitimacy in the view of the international community more or less automatically. Until a couple of decades ago, it was enough for a ruler to control a territory, and the people in it, in order to receive diplomatic recognition and take a seat in the UN General Assembly. It is still the case that most governments in the world are recognized on that basis and not on how they rule their countries. The management of the sovereign nation-states has for a long time been seen as an internal affair and of no concern to people in other countries. While Locke argued that countries should be ruled with the consent of its people and defended revolutionary methods to rid the citizens of a ruler that abused his power, he also seems to have regarded this as an internal matter.

However, to be legitimate a fundamental societal system has increasingly not only to be justified in relation to its purpose and to human nature; it also needs to meet ethical standards. In that respect it matters to the public opinion how it is governed. It may be due to the information age, it may have to do with the globalization process and the flow of migrants, but whatever the reason the public opinion is less and less inclined to regard governments that abuse human rights or corruptly capture the riches of their countries in their own pockets and keep their people in an artificial poverty as legitimate rulers. Politicians in the Western sphere are nowadays often using the language failed states about states that do not put the welfare of their people first.”<sup>267</sup> The government of North Korea may claim that it is the legitimate ruler

---

<sup>267</sup> Dahlsten, 2010, p 69

of an independent state, but it finds little support for that claim in the public opinion of the Americas and of Europe. The uprisings in Northern Africa have on similar grounds gained a lot of public support in the Western countries. “This new perception of legitimacy is also moving the borders between what is regarded as internal state issues and a concern of the world community. A widespread abuse of human rights is e.g. increasingly seen by the Security Council as a reason to intervene in what earlier was perceived as internal affairs of a state. Gradually, good governance has become the most important factor for the legitimacy of a rule and not the control of a territory in itself. In a similar way, the legitimacy of the global market economy cannot be judged without a discussion on how it is governed. It is a combination of a system and its governance that can give it legitimacy.

John Rawls, who has had a great influence on modern progressive liberals, made a very strict interpretation of legitimacy. He proposed: No regime is legitimate unless it is reasonable from every individual’s point of view. This is a far-reaching proposition that will make every existing and every possible regime illegitimate, at least if all individuals are accepted to be the best judges of their points of view and the reasonability of these views. Rawls was of course aware of that objection and therefore developed a procedure ‘under the veil of ignorance’ in order to reach consensus.”<sup>268</sup> The final goal is in this theoretical construct to create stable and just institutions. Amartya Sen has convincingly shown<sup>269</sup> that this is an approach that is highly unlikely to succeed; the underlying assumption that men can be expected to agree upon how to reason rationally is, as our discussion on human nature also shows, unrealistic. That people should be able to agree upon an end view on justice is also unlikely, according to Sen, a view I share.

“Rothstein and Lindvall associate the legitimacy of a regime mainly to the implementation and the output it delivers. Partisanship and the promotion of certain interests are the norms on the ‘influx’-side of a democracy, they note. Most people engage politically and in other ways to sponsor the interests of a certain group and a certain area (better communications, more support to families with children, reduced taxes for entrepreneurs, more subsidies to farmers and the like). But when they have succeeded in getting their partisan policies accepted in whatever form they want an implementation that is impartial and evidence-based. It is how a societal system lives up to that ambition that decides its legitimacy.”<sup>270</sup>

In line with this observation I offer the following criterion for the legitimacy of a fundamental societal system:

- Besides being recognized as a justified societal system, as defined in the last chapter, to be legitimate a societal system must have a structure and/or governance that ensures an outcome that is defensible to most people given shared values.<sup>271</sup>

A couple of clarifications:

---

<sup>268</sup> Dahlsten, 2010, p 69

<sup>269</sup> vgl. Sen, 2009, ch 2

<sup>270</sup> vgl. Lindvall and Rothstein, 2009, p 37

<sup>271</sup> Dahlsten, 2010, p 70

The first is that the choice of the word outcome is intentional. I have found the evidence that Rothstein and Lindvall have presented convincing. The input in the political system is often partisan, but people generally expect the politicians to find a compromise in the common interest that is implemented in a way that is acceptable to all. This duality in people's expectations is something with which newcomers to the political field often have difficulties.

Another clarification is that while shared values and interests is absent in Luhmann's sociology there is still evidence that they matter for the perseverance of a societal system. The example of states with several nations that now are broken down into smaller nation-states has already been given.

The critical question is finally if the minimum of shared values in relation to the functioning of the global market economy that we can identify are sufficient for creating legitimacy for the minimal possible regulation of that system that I claim to be imperative. I think it is, but it should also be noted that the shared value-base that I claim to have identified is far from what is needed to establish anything close to a World Community.

There are several ways in which an outcome in line with generally shared values can be ensured: The first is that the system can have an intrinsic structure, which ensures such an outcome. It is necessary to address this possibility as it gives direction on the need for action. There is no need for 'constitutional' frameworks or governance orders if the system in itself assures a perfectly reasonable outcome. I have in the chapter on self-regulation discussed whether there is such an intrinsic structure in the market economy and offered the view that there is no 'invisible hand' that ensures an outcome that is defensible to most people.

The other way to create legitimacy is through some form of institutional framework that can include 'constitutional' elements based on shared values, legislative powers, organizational structures and the like. The governance system can also be constructed in a way that enables continuous debate, a form of government by reasoning. Many see those two elements as alternatives. The 'transcendental institutionalists', lately led by Rawls, focused on the formation of just institutions. Others, such as Sen, have in their critic of Rawls highlighted 'government by reasoning' as a method to promote progress through comparative analysis. To my mind the two elements are complimentary.

However, the discussion on legitimacy has to start with a discussion around values. The proposition that a system to be legitimate needs to ensure an outcome that is defensible to most people given shared values is forcing a discussion on values and their role in relation to human nature and the societal systems. The questions are: What values are really shared and what values should decide the legitimacy of the different systems? How shall the potential conflict between consciously and subconsciously held values be reconciled? And should more strict demands be applied to the governors? <sup>272</sup>

---

<sup>272</sup>vgl. Dahlsten, 2010, p. 70

## Value base

Not all values are internalized or supported subconsciously. Values are, as has been explained, only to a limited degree genetically coded. “It is true that the evolutionary drivers, such as inclusive fitness that stimulates us to care about those with which we share genes, support what can be perceived as family values, but not because of their ethical character but due to their link to survival and reproductive success. Most values are acquired. John Locke was not completely, but almost right when he claimed that we are born a *tabula rasa*, i.e. a clean slate, without any innate values. Anarchists such as Robert Paul Wolff were on the other hand wrong in believing in an autonomous man with a built-in capacity to reach moral decisions.<sup>273</sup> Man is neither born a moral, nor an immoral being. The values we hold are mostly due to an ecological inheritance and a result of our upbringing. Values are learned and internalized early in life when we imitate parents and other persons close to us and when those role models teach us what is right and wrong by rewarding and scolding us. We can be taught to be honest, to show respect for authority, to take care of elderly and vulnerable etc.”<sup>274</sup> But we may also learn that the way to get respect is to show strength and exercise physical power. How to ‘tame thymos’ and steer it in a ‘moral’ direction has been an issue for philosophers since the days of Socrates. The pessimistic view of man’s morality that Friedrich Nietzsche expressed has concerned many, especially in the light of the atrocities during the twentieth century. The emerging answer to the concerns is thus that we have to closely scrutinize our ecological inheritance and that we have a moral obligation to involve ourselves in an ethical debate with members of our community and especially the young.

The importance of the pursuit of reason to address values and behaviours was identified by the Mughal Emperor, Akbar, in India in the late sixteenth century. He called for religious tolerance and mutual respect and saw public deliberations as a way to achieve the objectives, at the time when the Inquisition was in full swing in Rome.<sup>275</sup>

Reasoning is part of what makes the conscious self to accept values, but not all values are easily internalized, i.e. accepted by the subconscious. The subconscious self does not do reasoning and has to be told to cherish values by experiencing, by rewards and by blames. The internalization is crucial as it affects the self-image, the stereotypes and the on-line evaluation processes performed by the subconscious self. The subconscious processes evoke emotions, but they should be seen for what they are, namely signals from the subconscious to the conscious self which sometimes exposes a difference between the values we hold consciously and those we hold subconsciously.

“The first problem with reasoned values is that they are part of an ‘ideal world’. The philosophical discipline ‘Moral Philosophy’ dwells on this issue and it is not an easy inquiry. Rawls made, as already mentioned, a very ambitious attempt to create basic values through a thought process. He applied the concept of reflective equilibrium to explain the method of

---

<sup>273</sup> vgl. Dahl, 1999, p 42-43

<sup>274</sup> Dahlsten, 2010, p 73-74

<sup>275</sup> vgl. Sen, 2009, pp 36-38

justification underlying his theory of social justice<sup>276</sup>. The aim was to justify considered moral judgments found outside of science, taking no judgments to be established simply a priori. The larger suggestion was that moral truth is based significantly on which moral norms can be rationally chosen by members of a given society as norms under which they would be prepared to live. One weakness of the approach is, as already noticed, the underlying assumptions regarding human nature. That the process has some shortcomings is also demonstrated by the fact that the values Rawls champions are not generally shared.

Another issue is that values cannot be proved or be disproved by scientific methods. There is nowhere to look for the 'right' answer, no way of creating experimental conditions through which we can prove the existence or non-existence of a value. In that sense, values are just like mathematics. Mathematics is a tool that we have developed and that helps us analyze the world, but it is built on axioms that we by definition can neither claim to be true, nor untrue. The merit of mathematics is defined by its applicability, the way we can use the tool to organize knowledge and make predictions.

Societal values are to my mind of a similar character. The values shared in the Western societies have proved to be useful to us when organizing our societies. They have an 'axiomatic' character; they can neither be rejected, nor supported by scientific methods."<sup>277</sup> This observation is not unique. Kenneth Arrow recognized the need for 'axioms' in his development of the Social Choice Theory and other theorists of the same school have identified the axiomatic basis of the Rawlsian presumptions.<sup>278</sup> "Just like with mathematics the 'axiomatic' values can be reduced to a minimum through the application of logic; the consistency of the value system can likewise be improved. Many philosophers have strived to build a consistent and defensible value system that way. But at the end of the day when they have reduced the assumptions to a minimum, they still have ended up with 'value axioms' which they cannot logically deduct. Plato referred those to 'forms', a divine structure that supposedly exists independent of man, available only to gods and the enlightened. Locke and Nozick have claimed the existence of a natural order, of natural rights. The historically most common approach has been to claim that the 'axiomatic' values are directly or indirectly supported by a God or another divine structure. Kant saw for example the role of a 'Supreme Being'. Philosophers have found support for moral beliefs in Talmud, in the Bible, in the Quran and in other religious teachings.

A way of building justification among believers is to base the values on the common denominator of different religions. This has made sense historically and many constitutions are in practice built that way. But time has passed since religious leaders representing diverse churches were talking about the mountain that they were climbing together, although from different sides. Today the gap between people of different faiths is widening again; fundamentalists have been gaining ground. There is an atmosphere of distrust<sup>279</sup>, making any attempt to find common ground between different religions more difficult.

---

<sup>276</sup> See Rawls, 1971

<sup>277</sup> Dahlsten, 2010, p 72

<sup>278</sup> vgl. Sen, 2009, p 110

<sup>279</sup> Dahlsten, 2010, pp 72 -73

“A ‘common denominator’ justification that is embraced by believers also has the weakness that it not necessarily is seen as a justification by non-believers. This is one fundamental problem with the claim that there is a moral order independent of man. The value of such a justification rests in the eyes of the beholders. The argument does not convince those who are sceptical to the existence of the divine order. If a justification is based on a certain faith it may even alienate those of other creeds. A second more practical issue is that the perception may lead to an underestimation of the importance of maintaining shared values in a society as well as the difficulty in doing it.”<sup>280</sup>

Hayek writes somewhat ironically: “The most effective way of making people accept the validity of the values they are to serve is to persuade them that they are really the same as those which they, or at least the best among them, have always held, but which were not properly understood or recognized before.”<sup>281</sup>

### **Key values**

My view is that it is futile to claim that the values that are shared in the Western world should have a logical or ‘natural’ justification. The same, I claim, is true for values in the Asian and specifically Chinese tradition. This is only the first problem in the search of ‘shared values’. The second problem is that values are generally less shared than we want to know. Any meaningful discussion, which has the purpose of being inclusive, has therefore to be restricted to such key values that are an essential for the legitimacy of the governance of the market economy and relatively unproblematic part of the cultural heritage in most countries. For this discourse it is necessary to separate between the developed contentious political values we may hold and that can influence policy decisions taken within the systems on one hand and such basic values that are shared by a broad majority (which includes internalization) and that should influence the systemic level on the other. I will somewhat incorrectly call the latter values Key Values for short. The reasoned values, which I have chosen as a possible basis for the WMG, are selected with no other justification than that they seem to me to be part of a generally accepted philosophical heritage that finds its roots both in Western and Asian traditions. The selected values are: Trust in reason and evidence, liberty, security, and equality.<sup>282</sup>

The Key Values relates to the conscious and subconscious selves in different ways. Trust in reason and evidence is a value we can hold consciously, but bear little consequence for subconscious processes that do not do reasoning. It is a value that thus is unsupported by the subconscious processes. This can, as the example I have offered on the fright for flying shows, create cognitive dissonance in cases when the beliefs we hold subconsciously differ from those we hold consciously. If we want reason and evidence to steer how the market economy is governed we need to create environments in which the subconscious processes play an insignificant role.

---

<sup>280</sup> Dahlsten, 2010, p 73

<sup>281</sup> Hayek, 1944, p 161

<sup>282</sup> vgl. Dahlsten, 2010, p 73



The WMG should thus strive to steer the market economy in a direction of an outcome that

- is based on reason and evidence i.e. decisions should be taken after open and reasoned scrutiny and the consequences examined

There are many ways to reason that meet this criteria. To show the plurality of reasoning Amartya Sen has offered an enlightening example:

Three children – Anne, Bob and Carla – are arguing about who should get a flute. Three compelling cases are made. In the first Anne gets the flute because she is the only who can play, in the second Bob gets the flute because he is poorer than the others and cannot afford to buy a flute on his own and in the third Carla gets the flute because she has made the flute herself. Bob could expect support from the economic egalitarian, Carla by the libertarian and Anne at least to a certain extent, by the utilitarian hedonist. None of the arguments can be easily discarded as ‘irrational’.<sup>283</sup>

Sen used the example to show that it is likely that people will come to different positions on what is fair and just in many situations when they reason based on their respective values.

To reason rationally is also to retain an Open Impartiality, to use the language of Sen. With that concept Sen aims at highlighting the importance not to be over-confident in your own opinions but to be prepared to accept the views of scrutinizers, also when they come from other cultures. Such Open Impartiality seems especially important in the governance of the global market economy.<sup>284</sup>

The traditional liberal view is that liberty contains man’s right to fully control his possessions and protect his privacy. Freedom ensures that he can do what he likes as long as he does not hurt the interests of other men without compensating them. Freedom gives him the opportunity to pursue his objectives, but also ensures free choice, a lack of dependence and of interference. Liberty has many facets that are open to public debate and scrutiny and a pluralistic definition. A common denominator could be that the WMG should strive to steer the market economy in a way that

- supports liberty, especially man’s right to privacy and the civil right to fully control his possessions and do what he likes as long as he does not hurt the interests of other men without compensating them

There is a clear conflict between privacy and security, more on nation-state level than in the global market economy, although many policy issues have to be addressed in the latter case too. A tentative formulation of the objective could be that the WMG should strive to steer the market economy in a direction of an outcome that

---

<sup>283</sup> vgl. Sen, 2009, p 13

<sup>284</sup> vgl. Sen, 2009, ch 6. Open Impartiality is not uncontroversial. On p 406 he recalls a confirmation hearing with the new US Chief Justice John G. Roberts . Jr, in which he rejects an earlier decision by the Supreme Court because it referred to the reasoning of a German judge.

- supports security, i.e. as far as possible protects everyone from systemic harm as well as harm from other market actors

Liberty and security are part of the ecological inheritance in most countries and are in principle supported both consciously and subconsciously.

### **Equality - a contentious value**

Hayek recognizes that liberty, equality and security<sup>285</sup> have been the values that have attracted the most interest from liberal philosophers during the 19<sup>th</sup> century, but also how difficult they are to define, especially equality.<sup>286</sup>

Equality is a problematic value. Man is definitely not born with the idea that all men are of equal value and deserve the same dignity and respect; those are values that he may or may not have acquired as he grows up. Man is on the contrary born with a brain that creates stereotypes that he attaches to groups of people, to those that are like him, as well as to people who have another colour of the skin, that speak or dress differently, or worship in another way. Prejudice is another word for stereotypes that are irrationally diverse.

“Equality is thus a concept with many layers. Equality can for example mean equal rights, equal dignity, equal opportunities or equal outcome. It is not as easy to agree upon as many would wish. It was less than a hundred years ago that it was accepted in Western countries that women could be as suitable as men to participate in the governance of the nation-states and it was hard for the great-grandchildren of many of the former slave owners to accept that black men should have equal rights. I will here discuss some of perceptions around equality and their possible implications.”<sup>287</sup>

#### Equal value

To assign all men equal value is a central thought both in the democratic concept and in the Chinese socialist tradition. For the Levellers and the Puritans, who had a significant influence on the US Constitution, the intrinsic equality of man was a fundamental belief. The Leveller Richard Overton wrote: ‘all men are equal...delivered of God by the hand of nature into this world, everyone with a natural innate freedom and propriety.’<sup>288</sup>

The idea of everyone’s equal value is close to Rawls view on ‘justice as fairness’. Central to fairness is to take note of other people’s views and concerns and not be steered by prejudice or vested interests. It is linked to the demand for impartiality in the exercise of power by the public servants. Rothstein and Lindvall see impartiality in the implementation to be crucial to the perceived legitimacy of a regime.

#### Equal social rights

---

<sup>285</sup> vgl. Hayek, 1944, p 208

<sup>286</sup> vgl. Hayek, 1944, p 116

<sup>287</sup> Dahlsten, 2010, p 85

<sup>288</sup> Woodhouse, 1938, p 69 also quoted in Dahlsten 2010, p 85

The concept equality becomes immediately more problematic when equality is defined as equal social rights.

I have chosen to see the rights not as a systemic issue but as a policy question, to be debated in the pluralistic public reasoning that is an essential part of the governance.

### Equal outcome

The political scientist Robert A Dahl<sup>289</sup> criticizes “the concept intrinsic equality for being too weak and argues in favour of a ‘Strong Principle of Equality’ that recognizes the need both for political and economic equality. Held is propagating a ‘Principle of Autonomy’ and argues that autonomy demands equal opportunity to participate in public affairs and claims as Dahl that political and economic equality is a prerequisite. This is a very challenging proposition, which in practice is demanding equal outcome for the citizens both in relation to the public order and the market. We are far from that situation in the modern democracies and it is hard to see how we can get there without imposing conditions on the market economy that are far-reaching and that would alter its character – something any individual nation-state that wants to be part of the global market economy would be unable to do anyway. I also believe it to be a claim that is unsupported by human nature.”<sup>290</sup>

### Equal recognition

“One of the findings around human nature is that our need for recognition is an important driver. But do we need equal recognition? In a contemporary definition by Dworkin<sup>291</sup> ‘moral equality’ is to be understood as prescribing treatment of persons as equals, i.e., with equal concern and respect. Humanitarianism, on the other hand, which recognizes that human beings are all of equal value, does not demand that they are treated uniformly in any respects other than those in which they clearly have a moral claim to be treated alike. Stanford Encyclopaedia of Philosophy notes: ‘Present-day philosophical debates are concerned with the kind of equal treatment normatively required when we mutually consider ourselves persons with equal dignity.’<sup>292</sup>

Fukuyama uses the term *isothymia*<sup>293</sup> to describe an all-pervasive desire to be recognized as the equal of other people. This is according to Fukuyama a futile desire. While capitalism is capable of creating enormous amounts of wealth it will, Fukuyama recognizes, continue to fail to satisfy the human desire for equal recognition. ‘With the division of labour come differences in the dignity of different occupations’, he notes. ‘In prosperous democracies, the problem of poverty has been transformed from one of natural need, into one of

---

<sup>289</sup> See Dahl, 1985.

<sup>290</sup> Dahlsten, 2010, p 86 - 87

<sup>291</sup> vgl. Dworkin, 1977, p 370

<sup>292</sup> <http://plato.stanford.edu/entries/equality/>

<sup>293</sup> vgl. Fukuyama, 1992, p 190

recognition.<sup>294</sup> But, he argues: ‘No existing liberal society is based exclusively on isothymia; all must permit some degree of safe and domesticated megalothymia, even if it runs contrary to the principles they profess to believe in’<sup>295</sup> The market economy gives unequal recognition and it cannot work in any other way. The only option left is to opt-out from the global market economy and we all know how unsuccessful such attempts have been.”<sup>296</sup>

### Common ground

Can these different views on equality be reconciled? More precisely: Can common ground be built on how to perceive the relation between the value ‘equality’ and ‘the global market economy system’?

There is an assumption underpinning the value Equality: People are to be seen as ends, as goals, in themselves. It is an assumption that can be broken down in two: Man has himself as an end and, secondly, man should treat other men as ends, not as means. Most liberal philosophers have that in common that they claim that man is an end in himself. Their basic criticism of other alternatives is often that they deny the individual the right to be the best judge of his own fortune. The libertarian Nozick argues e.g. in favour of ‘an end-state maximizing view’<sup>297</sup> - i.e. that man should as much as possible be seen as an end and not as a means - with the sole restriction that aggression against another being is forbidden. He claims that utilitarianism in contrast is a philosophy in which people are seen as objects, as means.

When trying to apply the value equality on the market economy it is to my mind necessary to withdraw somewhat from the assumption that man always should be seen as an end in himself. There seems to be ample evidence that our expectations are context-sensitive. We have internalized one set of expectations in relation to the public order and another in relation to market. Man expects to be treated as an equal when voting or when in front of a judge, but can do that without demanding to be regarded as an equal in every other sense. Man can specifically accept to be treated as means on the market, if that ensures that his desires are met to a greater extent, as long as he is treated with sufficient respect and, receives sufficient recognition.<sup>298</sup>

In support of this claim I offer the following evidence<sup>299</sup>:

Human labour is a means at the market place. Human labour is a production factor, just as land, factories, and other capital. In agrarian countries the land is the most valued factor. Farming represents often 90 per cent of the economies and to own land is to ensure your own support and the future of your offspring. The development of the feudal system was very much linked to the role of land in the economies of the time. “Wars were fought to gain land

---

<sup>294</sup> Fukuyama, 1992, p 292

<sup>295</sup> Fukuyama, 1992, p 337

<sup>296</sup> Dahlsten, 2010, p 87

<sup>297</sup> vgl. Nozick, 1974, p 33

<sup>298</sup> It should immediately be granted that what is sufficient respect and recognition is an issue affected by the situation of the persons concerned. Sen writes about the Objective Illusion, through which people in awkward situations try to see positive values in the tiniest of recognitions. See Sen 2009, p 165

<sup>299</sup> vgl. Dahlsten, 2010, p 88

and which of the feudal lords won was decided not in relation to the number of men whose lives they sacrificed, but in relation to how much land they had after the war in order to support future generations compared to how much they had before they entered into it.

When handicraft and trading started to be important those who were the main players in the emerging new economy were given influence, with the implicit purpose to ensure future provisions for the community. With the industrialization the new important production factor was the capital invested in factories and machines, in electricity and transportation systems. Man was initially expendable, a means to an end. The mechanization of the agriculture made most workers unneeded in the countryside, forcing them to offer their labour to unhealthy and dirty industries in the cities. Modern democracy in Europe did not begin to evolve until the steady flow of new workers dried up and the workers started to organize themselves.

In a global perspective, the process of urbanisation has not yet finished. It is still on-going in countries such as China and India where millions every year have been leaving the farming areas for work in the cities. During this process, they are in practice means, production factors, non-essential and replaceable.

Agriculture and industry have continued to mechanize in the most developed countries and produce steadily more with fewer employees; agriculture is employing less than three per cent of the total workforce in those countries and industry less than twenty per cent.”<sup>300</sup>The vast majority is starting to be employed in the services and knowledge industries and in those the human capital is the totally dominant production factor. Real estate is still a valuable asset in the service economies, especially if it contains natural resources, as is capital and factories that are crucial for industrial production and for export and import, but human capital has for a long time not played such a large role. The term ‘human capital’ is, however, another euphemism for humans as means, and not as goals. Human feet can in principle be replaced by a truck, arms by a robot, and brains by computers. From the perspective of the market humans are exchangeable with other means of production.

Industrialisation and globalisation have not taken place without conflicts. Trade unions and political parties have been created as an expression of anger over disrespect and unfair distribution of wealth. But the workers have seldom demanded a strictly egalitarian distribution of power and resources. They have asked for better conditions as they have felt that their desires have been insufficiently met and that they have been given insufficient recognition. Seeing the wealth creation potential of an increasingly global economy people in emerging and developing countries have been prepared to make a trade-off between their wish for equal treatment and the fulfilment of their desires. People have recognized the power of capitalism as a means to meet those desires. The reconciliation is that they accept being treated as means as long as their desires are reasonably met and as long as they are met with sufficient respect and are given sufficient recognition. The definition of what sufficient means is context-sensitive and obviously varies over time.

---

<sup>300</sup> Dahlsten, 2010, p 88-89

Forty years ago I wrote a thesis on ‘The value of human life in theory and in practice’.<sup>301</sup> The subject was chosen as it was the clearest case of conflict between seeing man as a means or as an end that I could figure out. The result of the investigation was quite enlightening; man is evaluated after his market value when the context is of market character, while he is attached an ‘eigenvalue’ when the context is public services. In other words, by market actors he was treated as a means and by public services as an end. A couple of examples: In the analysis related to traffic safety the cost of the loss of a life has to be evaluated. In the first generations of the macroeconomic cost-benefit calculations, when such analysis became trendy, the loss of human life was valued at the loss of production value. The consequence was that the society gained every time anyone in retirement or close to retirement was killed. When the calculations started to be understood by politicians they reacted and the economists added an ‘eigenvalue’ to the human production value in order to neutralize this effect. Ethical restrictions imposed by the politicians thus ‘corrected’ the economic analysis but they were not part of the original market-based analysis. I also found that there were different levels of safety standards for elevators in industrial buildings and office buildings reflecting the different production values of the blue-collar and white-collar workers. Another example: As part of the war in Vietnam, the Pentagon had to calculate the cost for losing a soldier and they only included the training cost of a new soldier; for a pilot that was quite a high cost; for a foot soldier it was negligible. The soldiers’ lives were means, resources, not goals. That way of calculating has changed as the US public has become much more concerned about the losses of lives.

In publicly owned hospitals that were part of the Swedish general welfare system there was found to be another culture. When having to decide which patients were to be given regular dialysis for kidney failure, or in more concrete terms, which patients would have to die and which were to be saved, the doctors needed ethical guidance. The principles that were followed were that those that had dependent children had the first priority, that young people were given priority over older, and those ‘important’ for society priority over those less important. Important could be anything from a company manager, to a doctor or a painter. The last criterion was the closest to market economy thinking they came.

The fact that unrestricted actors are guided by market economy principles, in different countries and in different environments, when they count the value of a human life as the production value, is evidence of the conflict between perception and reality. An unregulated market is not producing the ‘end-state-maximization’ that Nozick predicted.<sup>302</sup>

Another evidence of anecdotal character can be offered: I have been involved in a number of deregulations of public markets and have repeatedly found that people’s expectations change when the service no longer is a public service, but a service offered by a liberalized market. Air carriers were before the deregulations expected to have unity prices that were the same for all passengers. Today, almost no one who is boarding a low-cost airline can tell if he has paid more or less than the passenger on the adjacent seat. Telecom operators had before the

---

<sup>301</sup> The thesis is only available in Swedish. Dahlsten, 1970

<sup>302</sup> vgl. Dahlsten, 2010, pp 88-90

deregulations fixed prices; today they vary from company to company, from campaign to campaign. We do not expect it to be in any other way. When a service is offered by a public body we count on equal treatment, when the service is offered on the market we are looking for the best offer.

The reader may ask how these findings relate to the interpretation of human nature that has been introduced. One of the arguments in favour of seeing the global market economy as a independent fundamental societal system has been that the market economy relates more to subconscious processes, while a democratic nation-state is demanding more of conscious reasoning. The critical observer may notice that especially the last example shows that we have internalized opinions not only on market-driven services, but also on public services. Why would we otherwise react with anger if a public service provider is treating us in a different way than other users? The first answer is that subconscious processes are involved in almost all conscious reasoning. The subconscious biases are e.g. influencing our actions when we act in the public domain. There is nothing black and white about our relations to the public order and the market. The second answer lies in the stereo-typing that is a typical element of the subconscious processes and is part of our inconsistency. We have all of us internalized some belief of what a public service and a market service respectively should look like, including its relation to the equality aspect. When a service is moved from the public sector to the private market it is also moved from one of our stereo-types to another.

The resolution entails that the concept of equality should not be stretched in a way that comes into conflict with other human needs. “That man wants to be treated as an equal in affairs of the state and in front of the law does not imply that he has to be treated the same way when participating in the market economy. This can be seen as an inconsistency, and of course it is, but I prefer to see it as an acceptance of man as he is.

A careful reading of Kant’s second postulate shows that the distance to his views may not be all that far.”<sup>303</sup> He does not claim that man should in all respects be treated as an end. He only claims that man ‘must be treated never as a mere means but as the supreme limiting condition in the use of all means, i.e., as an end at the same time.’<sup>304</sup>

The WMG should thus strive to steer the market economy in a direction of an outcome that

- supports intrinsic equality, i.e. that all men are of equal value and ensures that man, when he is prepared to be a means to other men’s ends, in order to better meet his desires, is given sufficient respect and recognition.

### **A legitimate process**

---

<sup>303</sup> Dahlsten, 2010, p 90

<sup>304</sup> vgl. Kant, 2008, pp. 437–8 quoted also in Dahlsten, 2010, p 90

A minimum of shared values is not enough to create confidence in a global legislative process. It must be perceived as transparent and to be responsive to the demand expressed by entrepreneurs for change in the common interest.

A new approach must start from a narrative to which most people can relate. It has to recognize the reality as it is perceived by many, the despair they feel in front of unemployment, hardship and lost hopes. It must be open-ended, positive and tuned to the future. The narrative must be owned and developed in the schools, in the work-places and in the homes and there must be a brake with the past. It has to tackle the widespread suspicion, fed by the increasing inequality, that the global elite do not want people to know what it is up to. This distrust and the wide-spread apathy in many countries have to be replaced by engagement and a belief in the future. There must be no room for the feeling that the repeated story is another of the fairytales that has been spread with the ultimate goal for the global elite to enrich itself further.

The identified problems to be solved must be linked to a *demonstration effect* and be felt to be important, expressed in a transparent way and based on secured *evidence*. There should be no hiding that few of the global problems are well defined and well researched, no pretence that there are developed models of the global monetary market in which to test different scenarios. The story must admit that the limits to growth defined by environmental restrictions are understood to a certain extent, but far from fully, and that their links to the economy is insufficiently explored. There are many other examples. One of the present dangers is that less serious actors are spreading misperceptions that install unnecessary fear as well as unwarranted security. Imaginary problems may create public unrest for the wrong reasons while other real problems are left unattended. That is why I believe in Global Systems Science as one way of using modern IT technologies to better understand how the world really works and how things are inter-connected. There are many other scientific approaches that can be helpful and think-tanks and the like can play an important role in gathering and analyzing evidence.

It is not that we don't know enough to do anything and that there is no shared understanding of the challenges. We have sufficient knowledge, and we should act on the knowledge we already have. In the next chapter I will discuss the areas related to the global market economy in which we need global solutions and also indicate how solutions could look like. There is no need for a common view on these solutions at this stage. My purpose here is only to show that there are solutions to be found and that there is no reason to give up the search for such solutions. From public awareness rising can follow a public debate out of which hopefully will come improved or even better proposals than the ones I indicate.

This brings to the next cornerstone in a decision-structure that is effective, transparent and that can install confidence and that is the *Public Information Space*, to use the terminology of Will Hutton. That space has expanded dramatically during the IT revolution and contributed to a stunning progress in many fields. But it is not only a good thing. The challenge now is to be heard in the cacophony of voices and images. There are three elements in the global Public Information Space that I believe to be especially important in that respect– globally organized networks, social networking and media.



The latest years we have seen an explosion of social networking on the internet. Phenomena such as Face book, Twitter and LinkedIn have come to be named *social media*, the reason being that they not only network people, they also spread knowledge, initiate debates, and create opinions. Politicians have started to realize how important it is to be present in these media and many of them spend a considerable part of their daily life communicating with the public via social media in order to spread their political message. “Blogging” has for many, not only politicians, become a full-time occupation. The social media contribute to increased transparency, and their pure existence has made it more difficult for those in power, whether that power is public or private, to try to hide inconvenient facts or events. Also in countries in which the sites are forbidden there has developed an internet culture that has made it more difficult for officials and managers to hide their mistakes. One strength of the social media is that they in a very short time can mobilize a considerable opinion; they are for example claimed to have played an important role during the Arab spring. In a similar way, social media could play a significant role in the awareness rising and debate around the global market governance challenges and how they relate to jobs, sustainability and fairness.

A weakness of the social media is the overflow of information. *Journalistic media* are needed to help all of us to identify the most important developments. Modern journalists spend a significant part of their day screening internet and looking for news. The first the world may know of a disaster could be when an eyewitness posts a video on YouTube. It is in its turn a scoop for a TV reporter to be the first journalist to see that video. Bloggers can find their way to the public by first being observed by an ‘ordinary’ media. As there is so much out there, it is not easy for think-tanks and the like to get their message through. And it takes a lot to get attention. Political bodies often stream their deliberations openly on the web in order to reach people and offer transparency, but few follow the streaming. The most common reason why people without forewarning find themselves in front of decisions by bodies such as the EU is that the debate that actually has taken place never has been covered by ‘ordinary’ media. And as those media are fighting for their survival and to sell copies, they have a tendency to cover ‘difficult’ issues less and less and turn more and more to the merger between information and entertainment that sometimes is called infotainment. This is a long-term threat to democracy and I believe that media that fill a public service role need to be supported in whatever technical form they choose – the written newspaper, the electronic version, the radio or the TV. But that is a partly different story.

Better evidence, public awareness raising are key to the decision-making there is one remaining question, and that is how a governance structure can come about that can *decide* upon rules and regulations that are binding for everyone and that are enforced. That is what the global market economy and especially the global financial markets need and it is a key issue in the search of a solution.

The crucial *implementation* has to be followed by *monitoring* and *enforcement* to be credible. The effects have to be evaluated, leading to evidence gathering, making the governance a continuous process as shown by the figure below.



Figure 5. From Evidence Over Governance To Implementation

## XI. THE LEGISLATOR

The market economy is not very demanding on how we act as participants in the system. There is nothing saying that we on individual basis have to be rational or act in accordance with certain values as long as we follow the rules of the system.

The same freedom cannot be automatically granted those that have the responsibility to govern the market economy system. For the system to be legitimate they have to ensure “an outcome that is defensible to most people given shared values”. I have already discussed some of the demands that should be put on an independent judiciary and on executors within World Market Governance, but the main issue is of course the legitimacy of the legislator as that is where the real power will be located.

The most common proposals for governance of different aspects of the global market economy are, besides self-regulation, democracy and guardianship. I will, for reasons I will explain, add republicanism to the list of models worth considering.

Self-regulation has already been discussed in an earlier chapter and found to be wanting. I have also tried to show why a global democratic government is an impossible dream and would be unsupported by human nature. I will shortly discuss why one man-one vote is an unrealistic form of governance of the global market economy. There is finally the alternative with mixed models, such as the European Union. The recent development in the Euro zone has shown the shortcomings of such models. The inter-governmental element in the EU governance would, if it was to be copied, leave the global market economy with a management that has many of the same short-comings as the present governance. Any governance model that demands unanimity and an implementation depending on the will of the individual nation-states would be deficient in addressing the burning issues of the global market economy. We are thus left with two major alternatives – guardianship and republicanism.

### **Guardianship**

“A perennial alternative to democracy has, as Dahl points out,<sup>305</sup> been government by guardians, the notion being that ordinary people cannot be counted on to understand and defend their own interests – much less the interests of the larger society. People are just not competent enough. Confucius and Plato belonged to those who saw a system with knowledgeable and trained guardians (or mandarins as they are called in the Confucian tradition) as a better alternative. Confucianism has still a huge influence over the Chinese thinking and Plato’s book *The Republic* has inspired many followers; hierarchy has in fact been a more common way of governing in the history of mankind than democracy. In the thinking of Confucius and Plato, care should be taken in the selection and education of the guardians. They ought to be trained in the art of governing which was seen by Plato as a science. Both Confucius and Plato highlighted their dedication to the common good and their virtue. The citizens, recognizing the excellence of their rulers,<sup>306</sup> were expected to give them their loyalty and support, implying that the guardians were expected to rule with the consent of their people.

The idea of government by guardians has been criticized from different angles. While sharing the view that the people cannot rule on their own, the Republicans have claimed the idea that the guardians would be guided only by virtue and a commitment to the public good to be unrealistic. Democratic theorists such as Dahl<sup>307</sup> have focused on the argument that guardians should have special knowledge claiming that there is scarce evidence showing that some people are more apt to govern than others.”<sup>308</sup> He calls this the *Presumption of Personal Autonomy*: In the absence of compelling showing to the contrary everyone should be assumed to be the best judge of his or her own good or interests.<sup>309</sup> “Dahl claims first that there is no evidence that moral knowledge should be a science in the sense that there is an ”objective

---

<sup>305</sup> vgl. Dahl, 1989, chapter 4

<sup>306</sup> Plato went as far as suggesting that the gods had mixed gold in the nature of guardians, silver in the nature of auxiliaries and bronze in farmers and other workers.

<sup>307</sup> vgl. Dahl, 1989, chapter 5

<sup>308</sup> Dahlsten, 2010, p 97

<sup>309</sup> vgl. Dahl, 1989, pp 99-100

truth". His view is supported by our findings regarding human nature. Values are mainly acquired and they are not set in stone. Dahl also attacks the notion that there should be a public good that is anything more than the interests or the good of the persons who compose the collectivity, or are affected by it. While he notes that a person's interests may be broader than merely one's private or self-regarding interests, he asks, why human beings should value a human system above and beyond the value it has for them.

Dahl also attacks the guardianship view that some people should have instrumental knowledge making them more apt to be decision-makers. Quoting Georges Clemenceau's famous aphorism that war is too important to be left to the generals he gives a number of examples on military issues with strong moral implications on which generals are no more apt than the ordinary man to make a judgment. He also reminds us of research that has shown that experts are no better at forecasts than people in general.<sup>310</sup>

On this latter point Dahl's arguments are less convincing. They are basically anecdotal and are contradictory to other modern ideas on how to create efficient social institutions. A well-functioning public order is based not only on the notion that all have equal rights but also on the heralding of reason over prejudice and science over ignorance.<sup>311</sup> "Basic learning and training is generally seen as a social right and general education a prerequisite for an effective participation in public affairs. So why should the knowledge of the individual not matter when governing? The argument is confusing.

It is also easy to find anecdotal evidence that shows that individual knowledge does matter. It is e.g. obvious that some CEOs have been more successful in running their companies than others, that some doctors have a higher success rates in the operation theatre, and that trained plumbers, electricians and carpenters do a better job.

Part of Plato's criticism of the Athenian democracy was that it was a regime of rule by raw, unmediated, uninformed public opinion. Our inquiry into human nature shows that he makes a valid point. When a populous is gathered on a square to make an immediate decision there is a great risk that the judgment will be irrational. People will be influenced by the situation, by the inclination to abide to authority, intimidation, group conformity and other biases. They may end up taking an 'on-line' decision rather than making a considered reasoned judgement. The self-justification process ensures that they are unaware of their failure.

The way modern representative democracies work diminishes this risk, at least in theory. As Dahl points out: 'Modern democracies, with their elaborate systems of representation, delegation, committee specialization, and administrative expertise, have enormously increased the amount and quality of information and understanding brought to bear on decisions.'<sup>312</sup> It could be added that the system with representatives holds them accountable to those who have elected them. When taking a stance the representatives know that they have to be able to defend the decision to the electorate at a later occasion; at least that is the way it is supposed

---

<sup>310</sup> Dahlsten, 2010, p 87

<sup>311</sup> vgl. Dahlsten, 2010, p 97

<sup>312</sup> Dahl, 1989, p 77

to work. All these safeguards are in principle supporting a more conscious reasoned decision-making.

The ambivalence in Dahl's reasoning around the importance of knowledge seems to stem from a theoretical distinction that he makes between knowledge available to the representatives and their own knowledge. His view appears to be not only that all citizens should have the same right to participate in the election of representatives; they are also in principle equally electable and capable of holding office. The individual knowledge is deemed to be of little concern as the lack of such knowledge is expected to be compensated through the procedure. This is a discussion that brings us back to the points made earlier in this chapter around the different understandings of the equality of man.

The unresolved issue around individual competence makes the role and character of the representatives in modern democracies a contentious issue. In many countries with party systems and proportional representation it has been seen as desirable to have candidates that as a group are not only representing but also representative of the electorate. There should be 50 per cent men and women, young candidates as well as older ones, representatives with all kinds of working background, from the countryside, small and big cities etc. The idea is that the parliament should be a 'mini-electorate' and the presumption is, following Dahl, that all citizens in principle are equally fit to govern.

Other countries, which also regularly have political parties, have procedures in which the electorate chooses between different candidates. The presumption is that it matters who is President, Governor or Mayor and that not all candidates are equally fit to hold office even if they have similar ideas. Such representative democracies have combined the ideals of the Athenian democracy with the idea of guardians. Instead of being selected by the gods as proposed by Plato, or their predecessors as proposed by Confucius, the guardians are elected by the citizens. Also democracies with proportional representation have come to accept that individual knowledge and abilities matter and ministers are therefore often chosen outside the parliaments.

The return of guardianship as an element of the modern democracies is bolstered by the mounting complexity of the societies and the increasing role of the public sectors. This development is putting demands on the politicians that they sometimes have difficulties to live up to. The politicians are in many fields feeling forced to leave the real decisions to experts, giving them only vague direction through legislation. Dahl is arguing that policies should remain with the legislators and that the delegation to experts should be restricted to the choice of means."<sup>313</sup> "But the reality is different. The delegation has in many cases gone quite far. This development is especially present when it comes to the market economy. In most democracies the elected representatives have abstained from regulating the money market and left it to the Central Banks to make the decisions. The decision-making Governors of those banks consist regularly of seasoned experts with a long experience of the functioning of the financial markets. The presumption is that there is an objectively best way of managing the

---

<sup>313</sup> Dahlsten, 2010, p 98-99

market and that the selection of a group of independent guardians is the best way of ensuring that objectively correct judgements are made. This way of thinking has also influenced the organisation of global institutions such as the World Bank and the IMF. Dahl recognizes this development and concludes later: ‘With respect to decisions on crucial international affairs, then, the danger is that the third transformation will lead not to an extension of the democratic idea beyond the nation-state but to the victory in that domain of de facto guardianship.’<sup>314,315</sup>

### **The few and the many**

“Ever since Plato and Aristotle the role of the ‘few’ has been a contentious issue. It seems that all countries in all periods of time have had a tendency to develop some sort of aristocracy, oligarchy, nomenclatura or whatever the ‘few’ might have been called. In the earlier days the ‘few’ were owners of physical property, of real estate, and they were often easily identifiable and recognized.”<sup>316</sup>

“The issue is now that the development has created a new group of ‘few’, this time defined by their financial assets, and that this group has a vested interest in the governance of the market economy, an interest that may differ from the interest of the ‘many’. Karl Marx would have claimed that the answer to the question is obvious. A capitalist economy creates capitalists and they are getting increasingly powerful if their power is not hampered. There is nothing really wrong with this analysis; the problem was that the prescription did not work. Marx’ mistake was to believe that you could plan the economy top-down. Lenin’s that he, in order to move into a society without the ‘few’ - the society of dreams - saw the need for a guiding role of the enlightened Elite. One of the faulty perceptions was that the ‘few’, the nomenclature, would be prepared to give up their new-won privileges; as we all know, they were not.”

The tendency of all societies to develop a group of ‘few’ has been mostly ducked by democratic theorists, the assumption being that the problem can be handled through social engineering or by a radical transfer of economic resources from those with too much to those with too little. The claim of this inquiry is that the idea that nation-states could master the global market economy that way is presumptuous and that it is unlikely that a global ‘super-democracy’ will ever develop.”<sup>317</sup>

The interesting libertarian economist Tyler Cowen has gathered some data on the surfacing of the new financial elite in the US. The “share of pre-tax income earned by the richest 1 per cent of earners has increased from about 8 per cent in 1974 to more than 18 per cent in 2007. Furthermore, the richest 0.01 per cent (the 15.000 or so richest families) had a share of less than 1 per cent in 1974 but more than 6 per cent in national income in 2007”. Based on partial financial records one will “find a very strong role for the financial sector in driving the trend toward income concentration on the top. For instance, for 2004, nonfinancial executives of publicly traded companies accounted for less than 6 per cent of the top 0.01 per cent income

---

<sup>314</sup> Dahl, 1989, p 320

<sup>315</sup> Dahlsten, 2010, p 99

<sup>316</sup> Dahlsten, 2010, p 112

<sup>317</sup> Dahlsten 2010, p 113

bracket. In the same year, the top 25 hedge fund managers combined appear to have earned more than all of the CEOs from the entire SandP 500. The number of Wall Street investors earning more than \$100 million a year was nine times higher than the public company executives earning that amount”.<sup>318</sup>

“It can be seen as being in the interest of these, the ‘few’, to keep the myth of the rational economy led by an invisible hand alive. The myth ensures that the governance of the market economy is seen as a ‘technical’ issue best left to experts; it also ensures that no demands stemming from ethical values are put on the guardians. As a consequence there will be few restrictions on the possibilities of the ‘few’ to enrich themselves further. As most people want to see themselves as moral beings with high ethical standards the easiest way to reconcile the personal ‘greed’ and the ethical values is to support the myth; the self-justification processes that are so forceful are helpful in achieving such a reconciliation; capitalists don’t have to be acting in bad faith, even if many do; they may just fool themselves. There is an old saying that ‘the interest never lies’; a more proper formulation given contemporary findings about human nature is that ‘your interests may make you believe anything that helps you manage a cognitive dissonance’.

The fact that the old consensus culture is supported by the interest of the ‘few’ is important to grasp as it defines the uphill struggle for change. The link has been strengthened by the common background of the guardians and the economic elite. They are all most likely to have studied in the same business schools. Such personal links reinforce the group conformity. Many informal meeting places and societies have not only a social role; they also reinforce a common view. Similar forums have been created on a world-wide level in the wake of a more and more global market economy. The World Economic Forum and the Bilderberg Group are two examples of such places for the exchange of views across national borders. There are many conspiracy theories around those meetings; some even claim them to be meetings of a ‘Secret Society’, a form of informal ‘World Government’. As a participant in many such meetings I can testify that this perception is faulty; if anything the meetings share best practices, allow for diverse views to be debated, and create awareness of common problems. The fact that many participants listen more to some of the arguments is more due to the preset minds with which they attend the meetings than how the meetings are organized. The reinforcing role of these conferences on common perceptions is much more subtle than the conspiracy theorists realize, and the sceptics can be reassured that the present crisis has created vivid debates at these kinds of meetings.”<sup>319</sup>

A developed guardianship of the global market economy is against this background unlikely to be regarded as legitimate “by most people”. Given the history there will be a suspicion that the guardians will give priority to the interests of the few. However, everyone is in my mind better off accepting the reality that the combination of best practice systems that we in the Western world embrace, democracy and market economy, with necessity will lead to the emergence of a financial elite with resources to influence both how the markets work and the

---

<sup>318</sup> Cowen, 2011, pp 2, 4

<sup>319</sup> Dahlsten, 2010, p 113-114

democratic decision-making; man is after all prepared to be treated as a means if sufficiently respected in order to get his desires met and he accepts that there are those who may be more lucky on the market. The influence of the few on public affairs, especially the functioning of the markets, is a price that has to be paid if everyone wants to benefit from the wealth-creating capabilities of the market economy. It is to an external observer obvious that the US democracy already works in such a way and that it balances the interests of the many and the interests of the few.

It should also be noted that while people may react negatively to an order in which only the interests of the few is taken into account, they are likely to react negatively also towards an order in which citizens of all nationalities are given the same influence regardless of the size of the economies. The development in the Euro zone is in this respect offering some valuable insights. It is clear that the German population would feel it 'unfair' if the Greeks and the Italians had been given the same influence during the handling of the Euro zone crisis. A representation of the 'many' in the governance of the global market economy cannot be based on the 'one man - one vote' principle. The representation principles have to take into account that the nation-state is the level that we humans most strongly identify ourselves with and we would find it discriminating if our collective voice did not reflect the relative economic strength of the nation-states.

“The conclusion is thus not that a global governance of the global market economy should be created that breaks the power of the few; what is needed is a global governance structure that recognizes not only the interests of the few, but also those of the many, interests that also are quite legitimate, and that have to be represented in a way that is perceived as fair.”<sup>320</sup>

The liberalization of the financial markets has together with globalization created a powerful financial elite that is competitive and resourceful. But globalization has also increased global networking and cooperation between many groups with common professional background or shared interests. The information revolution has brought us social media that have proven to be powerful communication tools that has given the networks and engaged citizens a much stronger voice than their limited financial resources would indicate.

The financial elite may seem to have interests that are in direct conflict with those engaged in the protection of the environment and global development. But is not as simple as that. Some of the richest men in the world, notably Bill Gates and Warren Buffet, are engaged in the challenges of the developing world.

I have already discussed the role global networks, NGOs and think-tanks can play in evidence-gathering, awareness rising and the public reasoning in social and other media. That the financial elite also will be heard and participate in the decision-process goes without saying. But global networks of a different kind and with diverse motives than the financial elite can also play an important role, especially in ensuring transparency and checks and balances in the decision process. This observation speaks in favour of republicanism

---

<sup>320</sup> Dahlsten, 2010, p 114



## Republicanism

An alternative governance model to guardianship, “classical republicanism, stems from the Greek philosopher Aristotle. If anything the concept was inspired by the Spartans, the enemies of Athens. The followers of Aristotle have been as critical of the Platonian guardianship as they have of the Athenian democracy. In both systems they have seen a risk for corruption. Power can corrupt the guardians, but so can direct democracy its proponents. Demos is not a homogenous body with identical interest; above all Aristotle saw a conflict of interest between an aristocracy with physical and other properties and citizens without such assets. The risk was, as he saw it, that a ‘corrupt’ majority would illegitimately bereave the aristocracy of its rightful property. He proposed a model that balanced the different interests: a democratic and popular element, an aristocratic or oligarchic element and in the top a monocratic or monarchical element, a ruler driven by the ambition to enhance his own position, status and power. The classical republicanism can thus be seen as a rule of the one, the few and the many. The republican Rome with its system of consuls, senate and the tribunes of the people is an example of classic republicanism as is the Republic of Venice.

During the Renaissance Francesco Guiccardini and Nicolo Machiavelli rediscovered and reshaped republicanism, from partly other perspectives. They saw the necessity for the feudal ruler to gain consent both from the aristocracy and the public. In the eighteenth century the British adopted a ‘constitution’ in that spirit. The sovereign monarch shared some of his power with a House of Lords and a House of Commons. Baron de Montesquieu belonged to those heralding the system as an epitome of a perfect balance.

The Enlightenment and the liberal philosophy that followed in its footsteps paved the way for a new more radical republicanism. Hinted at by Machiavelli and proposed early by John Adams in America, radical Whigs and later by Thomas Jefferson these republicans put the citizens in the centre of their models, not the monarch. They saw the prospects of good government in the qualities of the people and wanted to balance the power of the single monarch or the few, while they agreed with the classical republicans that concentration of power is always dangerous.

Democracy was not a self-evident alternative for the founders of the US Constitution. They were influenced by Rousseau and Locke, who were far from being proponents of a purely popular rule, and they were influenced by the thinking of the republicans, especially the British. The British system was, however, a model not easily transferred to the young American federation. Without a king and without a natural hereditary aristocracy the founders had to look for inspiration from other sources. They found it in the thinking of Montesquieu who proposed another way of avoiding concentration of power – the constitutional and institutional separation of powers in three main branches: legislative, executive, and judicial.

In the US version the legislative members of the Senate and House of Representatives are elected, as are the Executive President and the Vice President. The most prominent judges are however appointed by the President after the selections have been confirmed by the Congress.

The members of the Supreme Court, who are appointed for life, see themselves as the Guardians of the Rule of Law and of the US Constitution.

The findings around human nature that have been highlighted in this inquiry support to a certain extent a republican approach to the governance of the market economy. It has already been pointed out that a democracy in which people are represented through elected officials has an advantage in relation to direct democracy, where people vote themselves, namely accountability. Representatives are accountable to the electorate, which makes them more likely to reason rationally and in a way that is defensible logically. Republicanism offers two other safeguards. The first was highlighted already by Aristotle; with bodies with different interests there is less risk for corruption. The second is that the separation of powers in different bodies with diverse objectives and dissimilar accountabilities will counter the risk for a destructive ‘consensus’ culture. How strong the self-justification process is on a collective level is one of the most stunning findings of contemporary research. It is to my mind quite obvious that the consensus culture that developed among the guardians of the financial markets had a detrimental effect and that there is a lot to learn from the republican thinking. Modern democratic and radical republican theorists alike have thus good reasons to question the guardianship model that has been adopted when it comes to the governance of the financial markets.”<sup>321</sup>

### **The Assembly**

Guardianship has an important place in the governance of the market economy, but has to be anchored in an election or selection process that creates legitimacy. The republican model can, if applied to the legislation process create such legitimacy. Following this reasoning I suggest two chambers in the legislature, one that reflects the role of the countries in the global market economy and that is the final decision-maker, and one that ensures a public scrutiny and thereby offers the checks and balances that the process needs.

A system with two chambers is common in many 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 U.S. and in Germany. The European Union has a similar construction. With the new treaty almost all legislation demands the approval both of the directly elected Parliament and the Council of Ministers that represents the interest of the nation-states. The problems for the Euro zone to agree on different actions are partly due to the fact that the important elements of the governance of the currency union never have been integrated in the EU community order. To reach decisions the countries have needed unanimity and often approval of the national parliaments, which has made progress very difficult. It illustrates the short-comings of an inter-governmental order.

---

<sup>321</sup> Dahlsten, 2010, pp 99-101

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’. China also seems to be slowly moving from a guardianship model to some form of republican model. The Party is still in charge of the State, the Armed forces, the Propaganda, and the Appointments of officials including Judges and Executives in the important state-owned companies. There are no built-in checks and balances. The situation is, however, developing in two ways: The Party has expanded its recruitment base to include successful students and entrepreneurs. It has also created what some perceive as an embryo to a Second Chamber to the People’s Congress consisting of several thousand representatives of the business community.

As one of the purposes is to create a legislation process, which gives a reasonable representation to the interest of the ‘many’, and ensures a broad and sustained demand in the common interest there are reasons to be inspired by the model with two chambers, of which one represents the countries and one gives those that have expressed strong interest and have substantial stakes in the global development the confidence that their interests will not be overlooked.

I call the first chamber that would be the final decision-maker for The Assembly. In this Assembly the recognized market economies could be represented in relation to their economic strength. The economic strength can be defined in several ways – GDP, share of the global trade and growth are possible factors to consider. The data could be historic but also include projections. That would initially give a strong voting power to the U.S., the EU and Japan - a voting power that rapidly will diminish as emerging economies will get an increased share of the votes. It is worth remembering that China is expected to surpass the U.S. as the largest economy in the world before the year 2020.

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. The majorities needed for decisions may also vary and depend on where to draw the line between the power of the Assembly and national and regional sovereignty. Some decisions may be taken by 60 percent majority; others demand something close to unanimity. Absolute unanimity should always be avoided as it makes the process prisoner of any individual country.

There are several advantages with The Assembly as a forum for legislation. The obvious 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 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 in countries where the governments rule with the consent of their people put pressure on their representatives to act in accordance with their interest when representing them in the Assembly. The Assembly should not be too large. It should be possible for people to identify the representative or representatives for their countries and how they are voting as that would increase both transparency and personal accountability.

## **The Council**

I have already discussed how the involvement of the global network community can strengthen the legitimacy of the decision process, and help in gaining support from those that have the highest stakes in the global market economy. To ensure transparency and checks and balances I propose a second chamber in the legislature, a Council. The Council could have similar powers to those of the British House of Lords; it could e.g. offer opinions on legislation and in case of difference in views influence or delay a decision by the Assembly. The purpose of the Council would be to ensure that the decision-making in the Assembly is evidence-based and transparent. The members of the Council should add personal knowledge and experience to the process. They can for example be seasoned economists and ecologists, business and union leaders, judges and lawyers. They could be appointed for a period of time by independent communities of NGOs, think-tanks and global networks and by international organisations such as the IMF, the WTO, the UNEP, the OECD and the FSB to ensure independence and create checks and balances. In this way the Council would represent both the interests of the financial elite and the interests of other stakeholders in the global market economy as they are channelled through global networks and NGO's. As the process is public the real influence of the Council can be expected to be larger than the formal one.

## **XII. WORLD MARKET CHARTER**

A process leading to World Market Governance has to start with negotiations between the nation-states that are expected to be the signatories. No other way is possible; the nation-state is the only level, due to its constitutional role, that can give the WMG the necessary authority and power. But it also has to be a transparent process that resonates with the expectations and demands of citizens and stakeholders. If not, the end result may be lacking the legitimacy that is key to success.

I propose that the treaty, which is a necessary result of any meaningful negotiations, is given a higher status, the character of a charter, proposed to be named World Market Charter.

A first task for the negotiators is to define the territoriality of the global market economy – a World Market Area. To be part of that area it would be natural if a country had to meet the requirements that the WTO has set up for a recognized market economy. An obvious precondition is that the country agrees to abide by the market legislations decided jointly in the community order. If it does not, it should risk exclusion. A third criterion could be that the country should belong to a currency regime that is flexible and convertible so that imbalances within the area can be levelled out. This is a criterion that obviously needs careful considerations.

“A Charter would also need to establish shared values. The value-base is imperative for the WMG to obtain reasonable legitimacy in the eyes of the general public. My assumption is that it ought to be possible to reach broad agreement on the reconciled values as described earlier.”<sup>322</sup>

The objectives of governance cannot only be technical as the overall role of the market economy is to contribute to the life, health, well-being and property of the population within its reach. There are also issues related to long-term sustainability and mutual benefit. The scope has to be broad enough to cover all the aspects of the global market economy that needs to be addressed. 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 objectives have on the other hand to be restricted. An overall purpose of the WMG is to find ways of strengthening the nation-states. The WMG should not be seen as a step towards a World Government. The Charter has to be as clear about what is out of the scope of the governance as what is within it. Domestic problems should be possible to tackle on a national level. No intrusion should be made on the role of nation-states to provide social programs and institutions in line with the expectations of their populations and their cultural values and traditions.

It can be expected that the discussions around the necessary border line can become vivid and influenced by different national interests.

A way to overcome the negotiation hurdles can be to follow the route of the European Union and agree on different majorities in the Assembly on different issues. While it may be obvious to most that binding and coherent regulations of the financial markets are urgent and need to be possible to decide upon with, say, a 60 per cent majority, the signatories may agree that regulations on the purchases and sales of assets and on trade at least initially would require a more qualified majority. When the WMG is in place and the trust in the institutions is increased a mechanism that would move an area within the overall scope from qualified majority to “normal” majority could be envisioned. Such a decision could e.g. be taken with a 95 per cent majority by the Assembly.

“There are many existing conventions covering different aspects of the market economy. They concern everything from trade, financial markets and exploration, to labour market conditions, maritime issues and environment. Such conventions can be partly integrated in a Charter, but the Charter cannot be expected to have the same clear language or scope as those conventions; the Charter will be the basis for binding legislation, while most conventions have a less formal implementation procedure. Countries can be expected to be much more

---

<sup>322</sup> Dahlsten, 2010, p 128

careful in agreeing to an objective that is enforceable than if it is just an expression of a generally desirable state.”<sup>323</sup>

The governance structure, here proposed to include not only an Assembly, but also a Judiciary and some executive elements, can also be expected to demand lengthy and difficult discussions, but it seems likely that they could lead to an acceptable compromise, if the issues around objectives and decision rules are overcome.

Finally, it is worth repeating that a broad demand from the citizens is imperative. The citizens must support the idea and believe that the global market governance is established in their interest. They must come to understand that such governance would not interfere with their right to decide social and other conditions within their own culture; that it on the contrary would support the sovereignty of nation-states. For that to happen it would be highly commendable if the negotiations on a possible Charter, when they are to start and even if they to their very nature have to be ‘top-down’, were to be conducted in an open and transparent way and documented in working papers. That is a highly unusual procedure in international negotiations, but it would add to the legitimacy of any Charter. A public scrutiny is essential as it would increase the chances to gain public consent. One of the reasons why the US Constitution is held in such a high regard is the documented and public trace that the process left. A Charter negotiated behind closed doors and without public debate risks creating the impression that the interest of the ‘many’ is left out and that the Charter is all about distributing power among the ‘few’. It is thus not just the content of a possible charter that would be important; it is also the way it would be created. A successful outcome requires a skilful negotiator and a carefully thought-through process.

### **XIII. PRACTICAL EXAMPLES**

How would the WMG work in practice? How can it address the challenges that the global market economy is facing? Those are relevant questions, but the inquirer is unlikely to find more than very partial answers in this discussion. The purpose has been to find an institutional way forward, not to prescribe a recipe for the contents of the decisions that could be taken by the Assembly. But it could still be worthwhile to indicate how the WMG could address some specific areas. The tentative exploration is not intended to be exhaustive or rank the areas of concern. The purpose is only to illustrate possible approaches of the WMG. In other words: What could a Rule of Law with a Legislator and a Judiciary add to the present inter-governmental order?

#### **A functioning financial market**

---

<sup>323</sup> Dahlsten, 2010, p 128

The benefits of capital mobility as argued by the IMF and other members of the Washington Consensus is that it allows global savings to be allocated more efficiently, channel resources to their most productive uses and thereby raise economic growth. The Keynes' generation of economists that created the Bretton Woods system agreed with the objective but had another view on the means. They wanted to promote trade, but put a limit to the possible damages on the world economy by the free flow of 'hot money'. The role of finance is now under debate and there are many economists who have started wondering whether Keynes' generation did not have a point.

In what way could the WMG contribute to solving the problems? Is not the issue, to quote Cameron, if there is political will? There is substance in his objection, but it is not the whole truth. A WMG legislator could take a more global view on these troublesome issues and would be less bound by national considerations. Evidence of the credibility of that assumption can easily be offered: It is e.g. quite obvious that European leaders when acting collectively in the European Union have been able to take decisions that they know are right, but have been unable to take individually. The members of the European Parliament also seem to feel less restrained by national considerations than their colleagues in the national parliaments. A Legislative Assembly can also act more promptly without having to take a pro-longed ratification or implementation process into account.

The situation that those involved in the global issues try to wrestle away power from domestic detractors in order to get things done is not a new thing. The Bretton Woods negotiations included from a U.S. perspective such a process. The U.S. Treasury wanted an international regime that would move the handling of future crisis and headaches to body outside the influence of the U.S. Congress while the Congress tried to hold on to those powers as much as possible.<sup>324</sup>

## **Trade**

“The market economy has a global reach. The WTO is the only organization with authority that matches that reach, which makes the WTO different from e.g. the IMF and the FSF. If the trade agreements that have been signed in the WTO system are breached the trading partners that have been damaged can be given the right to retaliate after an open legal process in which all parties are heard.

The free trade agreements are starting from the presumption that there is no free trade between nations. The process of opening up the markets has been driven both by the conviction of those involved that free trade will make everyone better off and by the principle of reciprocity: ‘I open up my markets if you open up yours’.

Most industrial products are today covered by trade agreements that ensure more or less free trade. The same is true for most commodities. In agriculture and in services, however, the level of protectionism is still very high. To move forward towards a more liberalized services

---

<sup>324</sup> Woods, 2006, p 19

market has been one of the main objectives of the still on-going Doha round. It can be noted that the global leaders in the G20 meetings have repeatedly committed themselves to conclude the round.”<sup>325</sup>

The question is in what way an added layer of the Rule of Law would help?

The first answer to that question is that the process for approval of the trade agreements would be altered. They would no longer have to be ratified by all the WTO countries, but could be turned into law by the Legislative Assembly. The majority needed would be agreed upon in the World Market Charter. One could expect it to be quite qualified for the more far-reaching type of agreements, but as there would be no demand for unanimity no single country (with the exception of the largest stake-holders) could block an agreement. In short, it would be easier to make progress.

The second answer is that international legislation could direct how bilateral agreements can be allowed to look like and be enforced. Such legislation would contribute to a more transparent and fair trade.

### **To buy assets**

“It is hard to see the principal difference from a trading point of view between buying goods and buying assets, such as shares and properties. The transactions are about allocating resources in a way that creates the most value. However, the right to own assets in another country is in principle not covered by international agreements. If there is any presumption it is the opposite one to the trade of goods; it is generally allowed to buy any type of assets if not prevented by laws in the country concerned. The issue is that those laws as well as the public opinions vary quite a lot. Foreigners are e.g. not allowed to own a majority stake in an American airline and the purchase of ports by Arab funds has created negative reactions. China is protecting many sectors from foreign investments, especially sectors dominated by old state-owned companies. European leaders are expressing concerns about foreign governments investing in critical infrastructures in their countries, in some cases even when those governments happen to be partners in the European Union.

The oil-rich countries have started Sovereignty Funds that have worried the public opinion as they have the resources to buy up major assets. At the same time the American and European public opinion is - illogically it may seem - in favour of their companies buying businesses in the Asian economies; the West as well as China is incentivizing and pressing Arab and other developing countries to allow their companies to get the right to exploit energy resources and raw materials such as oil, gas and metals.

The lack of a coherent international framework has created a number of unnecessary international clashes as globalization is moving on. There is a need for a global law and order

---

<sup>325</sup> Dahlsten, 2010, p 131



also when it comes to the acquisitions of assets. One responsibility of the WMG could therefore be to negotiate a multilateral agreement on the right to own assets in another country. It could, as the trade agreements, be based on the principle of free and open markets and on reciprocity. Such an agreement, that could be turned into law by the Legislative Assembly, would counter the development towards violent confrontations where in many cases the right to own assets is the underlying reason for the conflict. It would probably be helpful if the negotiations came to be connected to the overall trade negotiations.”<sup>326</sup> When a law is approved the nations would be forced to follow it and the Judiciary would ensure that they do.

Many acquisitions of assets are today regulated in a weave of bilateral agreements covering Foreign Direct Investments (FDIs). Those arrangements are often criticized for having a negative effect on competition and create entry barriers. The WMG will not be able to solve all global conflicts related to the right to own assets in another country as all countries will not be members, but the WMG would be able to establish an international standard, a standard that if necessary could be enforced on states that are not recognized market economies.

### **Competition, intellectual property rights and sound trading practices**

Effective international competition demands clear rules and a level playing field. The competition legislations of individual countries and trading blocks are partly overlapping, partly in conflict from the perspective of international companies and entrepreneurs. The same is true for intellectual property rights such as patent law. And as Rodrik points out: “Many domestic regulations and standards discourage cross-border transactions, even when they are not primarily aimed at raising barriers to trade. Differences in national currencies, legal practices, banking regulations, labor market rules, food safety standards, and many other areas raise the costs of doing business internationally.”<sup>327</sup> International legislation and a Judiciary that can enforce common conditions would be a great step forward.

“Corruption is also all too common and difficult to root out, even in many democracies. An international legislation around trade practices may help in advancing the fight against corruption.”<sup>328</sup>

### **The market actors and the environment**

“The protests against the WTO have many roots. Some of the protesters seem to be governed by pure self-interest, but there are also those that raise their voice for very good reasons. They want e.g. to stop climate change, the melting of the Arctic ice, they want to stop the destruction of the rain forests, the spreading of the deserts and the pollution of air and water.

---

<sup>326</sup> Dahlsten, 2010, pp 131-132

<sup>327</sup> Rodrik, 2011, p 20

<sup>328</sup> Dahlsten, 2010, p 135

And their concerns are justified; a functioning market economy must live in harmony with nature.”<sup>329</sup>

The best way to tackle this type of externalities is to integrate them into the market system. International legislation could ensure that proper prices are set on negative environmental effects; it could outlaw the trading in goods and services that have unacceptable environmental effects. The Judiciary can ensure that the legislation is followed.

### **To tax the wealthy and avoid regulatory arbitrage**

Financial regulations in the form of international legislation would effectively block regulatory arbitrage on the financial markets. However, similar problems need to be solved also in other areas. The weave of international tax agreements, especially double-taxation treaties, is extremely complex and to follow the threads is almost impossible, but for those who have the incentive and the resources to look for loopholes. One area of importance for the nation-states is the domiciliation of companies and citizens, i.e. to decide where and how the subjects should be taxed.

International legislation that harmonizes not taxation, but the relations between different countries tax systems and that regulates domiciliation would be a major step forward to a more fair taxation of wealthy and less wealthy citizens and companies.

### **The conditions for the developing countries**

“Franklin D Roosevelt famously said 1944: ‘People who are hungry, people who are out of a job are the stuff of which dictatorships are made.’ To quote Barack Obama: ‘Nobody likes being poor or hungry, and nobody likes to live under an economic system in which the fruits of his or her labour go perpetually unrewarded.’<sup>330</sup> A state with a system that does not meet the basic needs of most of its population is not a stable state.”<sup>331</sup> Many claim that the Western World never can feel safe as long as so many are living in states that do not deliver full benefits to their citizens. Therefore, they claim, there is a need to spread good governance around the world, introduce citizens to market economy, fight corruption and create the rule of law. But the way to do it is not simple and when the motives are blurred the efforts may be futile.<sup>332</sup>

Many in the world who are living in poverty are living in countries that sometimes and somewhat misleadingly are called developing countries. The truth is that there are few of the countries that really are developing and that many of them are going nowhere. They need the support and the solidarity of the developed countries and the cost to eradicate poverty would in a global perspective be negligible.

---

<sup>329</sup> Dahlsten, 2010, p 133

<sup>330</sup> Obama, 2007, p 315

<sup>331</sup> Dahlsten, 2010, p 133

<sup>332</sup> vgl. Dahlsten, 2010, p 134

There is no need to reinvent the wheel. There are already many actors involved, development aid agencies, churches, charities and the like, actors that are better suited for the purpose. The UN has also many branches that are engaged in development aid. Most of them have the principle one country-one vote, which gives the development countries a decisive say on the organization of the aid. The UN family has many faces – the World Health Organization (WHO), the UN Development Program (UNDP), The Food and Agriculture Organization (FAO), the UNICEF to mention a few of them. The World Bank that is formerly outside the UN family has acquired the legitimacy to coordinate development aid in many cases; the Bank has also introduced new schemes to support investments in infrastructures.<sup>333</sup> The G20 has during the financial crisis tried to ease the credit squeeze for developing countries, who have found it increasingly difficult to get credits, by committing more support via the IMF and the World Bank. The Chinese has also supported own channels with the same purpose, the Asian Monetary Fund and the China Development Bank.

Few developing countries can be expected to be members of the WMG, but the WMG could take steps that would enhance the situation in the developing countries.

The most important would be to conclude the Doha Round in the WTO negotiations in a way that gives the developing countries the chance to export their agricultural products on fair terms. A change of the so called TRIPs would, as mentioned before, give the developing countries the possibility to export also other products on more equal footing. The trade regime could in addition include demands on environmental and labour conditions that would prevent the exploitation of nature and people in the developing countries.

A further supporting action would be to increase the global fight against corruption. Unconditional and generous development aid seems to corrupt the rulers, which became evident at the downfall of some of leaders in the Arab countries during the ‘Arab Spring’. One striking example: While the common Egyptian is worse off than twenty years ago, the unseated ruler and his family had gathered a fortune that out-sizes the generous help from US taxpayers during the same time period. If corruption is going to be effectively addressed, it is putting a pressure to act also on the developed countries. We Europeans need, to start with, stop putting a blind eye to what is going on in our own union. Corruption has to be fought, and fought hard, if the populations in Greece, in the South of Italy and in many new member states are going to improve their conditions.

## **XIV. BROAD AND SUSTAINED DEMAND**

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

---

<sup>333</sup> vgl. Dahlsten, 2010, p 134

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 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.

Would global leaders have been better off if they had been more open and their deliberations been more transparent? Would the German and British populations have been more understanding, if they had realized that a default by the states of Ireland, Greece and Portugal would have forced another bailout with taxpayers' money of the German and British banks, stuffed as their coffers are with bonds issued by those countries? I am not sure what the answer is, but I have a growing feeling that opaque, in-transparent global decision-making is at the end of the road.

I have presented a vision on how a developed, effective, transparent and comprehensive governance structure, World Market Governance, could look like that supports the two purposes: proper governance of the global market economy and a strengthening of the nation-states. It is limited in scope and objectives; the reason being that it should not come into conflict with the role of nation-states; the centrepiece is the Rule of Law, legislative powers and a Judiciary. I have tried to take both the contemporary findings around human nature as well as present-time and past-time experiences into account. The proposal is not to be read as written in stone; it is more of an approach than a recipe, but as such I believe it to be relatively unique.

There is a vivid public debate on the negative consequences of globalisation, but they are following paths already tested and rejected. Many propose a re-nationalisation of the market economy regulations. That is the route that was taken at the end of the previous globalisation period a hundred years ago, and it ended in a terrible depression. It is certainly not to be recommended to make the same mistake twice. It would also be to deny the emerging and developing countries the possible gains of the positive forces behind globalisation.

The other alternative on the table is to develop some form of global democratic government and many have been engaged in efforts to develop the UN structure in such a way, and still are. Those efforts have, however, gone nowhere, the main reason being that the UN neither is built upon a logic that is democratic, nor on a structure adapted to the conditions of the emerging global market economy. My findings also indicate that the idea of a global

democracy is misdirected. It is the global market economy that needs global governance, not the global society, for which subsidiarity should be the guiding principle.

Can the tide be changed in favour of more proactive and comprehensive governance of the global market economy? It is clear that if anything is going to come about for real, it needs to be initiated “top-down”, in a similar way that the UN Charter and the Bretton-Woods agreement were created after World War II; The political will may be an issue, as indicated by David Cameron, but I would suggest that the will is very much linked to the politicians perceived room for manoeuvre; the issue is how to create the political space for the global leaders to act when the constituencies, which are holding them responsible, are national.

The inadequate ‘bottom-up’ and ‘catch-up’ response to the progress of the global market economy is seen by many as the only politically possible route. The question that I so far have not addressed more than in passing is how the alternative vision I have sketched can be turned into reality, if at all. To quote an old Prime Minister: It is not enough to come to understand what the right thing to do is. When you have reached that goal you have only done half of the work. It is not until you have been able to convince others that you are right that your task is fulfilled<sup>334</sup>.

The remaining question is thus if the vision of World Market Governance can become reality. I have already quoted Woods and Mattli a couple of times on what it takes to create regulations in the common interest and avoid regulatory capture, They have researched the conditions under which such demand can be created and made some valuable observations.

They highlight three I’s – *information, interests and ideas*, as being imperative for the expansion of demand. People have to be made aware of the social costs following the capture of regulations by special interests. Pro-change groups must succeed in building broad alliances and they see public and private entrepreneurs in a pivotal role. The alliances should be built upon shared interests and shared ideas.<sup>335</sup>

To create broad public awareness *the demonstration effect* is crucial. Mattli and Woods give several examples: The first is the drug thalidomide: Some 8 000 to 12 000 infants were born with stunted limbs and other defects as their mothers had used the “safe” drug early in their pregnancies. That scandal changed the ways of the drug administrations. The nuclear meltdown in Chernobyl came to have a similar dramatic effect on the nuclear industry.<sup>336</sup>

But it is not always that the demonstration effect and the broad demand it creates has a lasting impact. In 1984 some forty tons of poisonous gas leaked out from a pesticide plant in Bhopal, India, killing thousands, but in the end the only thing that happened was that the chemical industry adopted a voluntary code “Responsible Care”, which according to scholars that have studied the impact is weak and of little restraining effect.

---

<sup>334</sup> From a speech by the Swedish Prime Minister Olof Palme to his new Cabinet in September 1982 (private notes)

<sup>335</sup> vgl. Mattli and Woods, 2009, p 21

<sup>336</sup> vgl. Mattli and Woods, 2009, pp 22-26

The latest financial crisis is another example: Governments responded to the public outcry but putting forward comprehensive packages of new financial regulations. The U.S. Frank Dobbs Act was e.g. on 2000 pages. Many issues, such as third-party risks, global money supply, imbalances, and currency relations, were, however, left more or less unaddressed by the major countries. And those that were addressed were first of all addressed in different ways in different countries and finally watered down in the process through the parliaments. The issue is that the demand for regulation in the common interest that was initially broad was not sustained through the whole process.

The consequences are many: The European Commission has expressed concerns that the Basel Two agreement only has been implemented in the US to the order of Basel 1.5. Goldman and Sachs that advised the Greek government on how to 'hide' the real deficit and that was saved by the American taxpayers through AIG just three years ago, is for example already trading with its own capital, using a loophole in the new regulation.

Some of the demonstration effect of the financial crisis has been used by the Europeans politicians in order to improve the long-term functioning of the Euro Zone. The steps in the development of the European project have often come as a response to a crisis of some sort. The European experience is that a crisis helps the politicians 'to do the right thing'.

The issue now is that the demonstration effect of the latest financial crisis is starting to wear off. It is not self-evident that people will continue to connect mass unemployment and hardship with the banks. It is more likely that they blame their politicians.

The entrepreneurs are important for regulatory change. Mattli and Woods have identified a number of important entrepreneurs that can help drive change in the common interest.

The first are the *Nongovernmental Entrepreneurs of Regulatory Change*. NGOs have played a major role in driving human rights issues, and in creating public awareness around events, thereby contributing to the demonstration effects, but it must also be recognized that they when it comes to e.g. environmental issues and the functioning of the market economy often have lacked the resources for a sustainable campaign. NGOs who are engaged in climate change are generally frustrated about the lack of decision power on the global level. The UN decision structure is obviously not suitable for addressing market issues and externalities.

Another group of NGOs with strong views on the responsibilities of major economies are those engaged in development aid. Many of them criticize the existing trade regime for being too oriented towards the interest of the developed countries and too little focused on the needs of the developing countries. For those NGOs to be able to interact with a governance structure that is transparent and has decision powers could be perceived as a major step forward.

What is needed for those who support change to win the fight in the public information space is to engage a broader part of the civil society in awareness raising and the creation of alliances and to use the new media in that effort.

Economists, political scientists and other researchers can also play a significant role in achieving that goal. I have already discussed the formation of a Global Virtual Research Community for Global Systems Science. Such a community can play an important role in the awareness raising by spreading knowledge and initiate an exchange of views between experienced and new researchers. It could counter the perception of the economic science as a closed “shop” with a destructive consensus culture by having a public website, participate in social and other media, organize workshops etc.

An important group are the *Public Officials as Entrepreneurs for Regulatory Change*. In this group I include insightful politicians. My perception is that this group is much larger than generally perceived and that it is growing. The view that there is a need for more coordinated governance of the global market economy seems to have a relatively broad support among decision-makers; this is especially true for global leaders, who through initiatives such as the G20 have tried to respond in concert to the latest financial crisis and to build improved governance "bottom-up" and found the results to be disappointing.

National leaders are also increasingly aware that their possibilities to fulfil their important social role are undermined by the fact that wealthy citizens and global companies are increasingly using the arbitrage possibilities to avoid paying taxes. The politicians know that they if they are to regain the sovereignty to decide in an independent way on the social conditions in their own countries need to create globally adopted legislations that diminishes the space for regulatory arbitrage.

Politicians are not the only public officials in favour of change. I have found a lot of support among leaders in the IGOs, in think-tanks and among governmental experts in Washington, Beijing, Paris and other places; the objection, or perhaps more correctly question, which they table, is how the novel vision, which they embrace with some sympathy, can be turned into reality.

The third group that Mattli and Woods have identified are *Private-Sector Entrepreneurs of Regulatory Change*. Those are in the experience of Mattli and Woods the entrepreneurs for change with the best possibilities to mobilize the necessary perseverance and resources for a successful campaign.

Four categories of corporate entrepreneurs are identified.

1. *Corporate consumers*. Such companies lobbied e.g. successfully for the abolishment of the telecom monopolies. They have a strong interest in addressing cartels and hindrances for competition that drives e.g. commodity prices.
2. *Corporations at risk*. Insurance companies forced maritime safety regulations by refusing to continue to insure ships. Many companies will be at risk, if the counterproductive incentive structure for the financial industry remains unchanged. A financial regulatory regime that creates predictability and gives priority to the main objectives of the banks, namely to give

returns to savings and to finance business and sound investments, would be in the interest of most of the industrial actors.

3. *Corporate newcomers.* The business opportunities are enormous. The technological progress under way is fantastic and new technical solutions to the problems the world is facing are developed every day. Green cars, solar energy, new solutions to the need for clean water, novel sewage and garbage treatments, new drugs and medical applications – the list of new inventions is endless. But to reach the users they need a functioning market.

4. *Corporate levellers of the playing-field.* Industry is dependent on level playing fields and on predictability and it suffers when the global economy is moving from crisis to crisis. Common rules for competition, intellectual property rights, exploration rights, and the rights to buy assets would be welcome by most global industrial actors. The involvement of business organizations in the discussion is imperative.

A more difficult task is to gain support from the financial actors, who often thrive on uncertainty and risks. As long as the actors feel protected by the nation-states, being too important to be allowed to fail, and as long as any default has a negligible effect on their own salaries and bonuses, while risk-taking can create fortunes, the actors will try to resist attempts to reduce the risk-level. It is an important task for financial regulators, as far as possible, to align the interest of the actors with those of the society as a whole. Such actions together with peer pressure from industrial actors may create a new climate. The proposal I have made also recognizes that this increasingly powerful group needs proper representation in the global governance structure.

So far I have discussed how global governance of the market economy can gain support by civil society and the business community in the Western hemisphere. It is as crucial a question how support can be built in the emerging and the developing countries. China is in the short term the most important actor. The problem is that China sees most proposals aimed at improved global governance as an attempt to restrain China and prevent its growth. China is a country with two faces, one developed and one developing. The latter China needs the growth to catch up.

To counter this climate of suspicion it is critical to involve China in all levels of discussions. The Chinese leaders need to take part in any reflections initiated by their peers among the global leaders; a way to commence could be to hammer out a possible agenda. Chinese researchers should be involved in the Global Virtual Research Community and invited to workshops organized in cooperation with think-tanks, NGOs and the business community from different countries, including China.

The Chinese have to be convinced that it is in their best interest that the global market economy is properly governed and that a new financial crisis would have a detrimental effect on the world economy and most likely hit the Chinese economy in a much more severe way than the last one. They must also realize that the decisive influence they have on world affairs today is a window of opportunity. India, Russia and Brazil have together almost the same GDP as China. Today China has the fastest growing economy, but that may change, when the



Chinese population between 15 and 64 stops growing in five years' time. China cannot count on having the same bargaining power for ever.

To create the political space for action is not an easy undertaking; it will take patience; in the worst case it will take a new crisis. Meanwhile the globalisation process is moving on at a rapid speed; if governed the right way it can benefit the whole of mankind, if not we may face an unprecedented backlash.

## XV. REFERENCE LIST

- K W Abbott and D Sindal, *The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State* in Mattli and Woods (ed), 2009
- J Adams, *On the Rule of Law, Part: The First*, art XXX, 1780. <http://www.heritage.org/initiatives/first-principles/primary-sources/massachusetts-constitution> (on the web 2013-03-02)
- M Allingham, *Rational Choice*, MacMillan Press, 1999
- Aristotle, *The Nicomachean Ethics*, transl. D Ross, JL Ackrill, and JO Urmson, Hackett Publishing, Oxford, 1985
- E D Beinhocker, *The Origin of Wealth. Evolution, Complexity, and the Radical Remaking of Economics*, Harvard Business School Press, 2006
- M Billig, *Arguing and Thinking. A Rhetorical Approach to Social Psychology*, Cambridge University Press, 1987
- Lord Bingham of Cornhill, *The Rule of Law*, Speech for the Sir David Williams Lecture in the Law Faculty of Cambridge University, November 16, 2006, <http://cpl.law.cam.ac.uk> (on the web 2013-03-02)
- L Blankfein, *I'm doing God's Work*, Meet Mr Goldman Sachs, interviewed by John Alridge in *The Sunday Times*, London, [http://www.thesundaytimes.co.uk/sto/news/world\\_news/article189615.ece](http://www.thesundaytimes.co.uk/sto/news/world_news/article189615.ece), (on the web 2013-03-02), 8 November 2009
- G V Bodenhausen, C N Macrae and J V Sherman, *On the Dialectics of Discrimination: Dual processes in Social Stereotyping* in S Chaiken and Y Trope (Eds.) *Dual-process Theories in Social Psychology*, Guilford Press, 1999
- R Bonk, *The Romantic Economist. Imagination in Economics*, Cambridge University Press, 2009
- H Brown, *Rationality*, Routledge, 1988
- D Cameron, *Governance for Growth, Building Consensus for the Future*, <http://www.g20.utoronto.ca/2011/2011-cameron-report.pdf>, 2011 (on the web 2013-03-02)
- R B Cialdini, *Influence, Science and Practice*, Pearson Education 4 ed, 2001
- T Cowen, *The Inequality That Matters*, *The American Interest Magazine*, Jan.-Feb. 2011
- R A Dahl, *Democracy and its Critics*, Yale University, 1989
- U Dahlsten, *Människovärdet i Teori och Praktik*, Handelshögskolan i Stockholm, 1970
- U Dahlsten, *Market Economy, Democracy and Human Nature*, i2010, Other Reports <http://www.globalutmaning.se/wp-content/uploads/2013/03/EC-Study-on-Market-Economy-Democracy-and-Human-Nature-2010.pdf> (on the web 2013-03-02)
- U Dahlsten, *The Myth of The Rational Man*, [www.globalclimateforum.org/fileadmin/ecf-documents/publications/articles-and-papers/THE\\_MYTH\\_OF\\_THE\\_RATIONAL\\_MAN\\_2011-11-27.pdf](http://www.globalclimateforum.org/fileadmin/ecf-documents/publications/articles-and-papers/THE_MYTH_OF_THE_RATIONAL_MAN_2011-11-27.pdf), 2012 (on the web 2013-03-02)
- P F Drucker, *The End of the Economic Man. The Origins of Totalitarianism*, 1939, Transaction Publishers, Third Printing 2009
- J S Dryzek and P Dunleavy, *Theories of the Democratic State*, Palgrave MacMillian, 2009

- R Dworkin, *Taking Rights Seriously*, Harvard University Press, 1977
- I Fisher, *100 per cent - Money*, Adelphi, 1935
- S Fisher, *Capital Account Liberalization and the Role of the IMF*, Presentation at the seminar on Asia and the IMF, Hong Kong, September 19, 1997  
<http://www.piie.com/fischer/pdf/Fischer144.pdf> (on the web 2013-03-02)
- P Flaschel and S Luchtenberg, *Roads to Social Capitalism. Theory, Evidence and Policy*, Edward Elger, 2012
- F Fukuyama, *The End of History and the Last Man*, Penguin Books, 1992
- F Fukuyama, *Trust*, New-York Free Press, 1995
- G Gigerenzer, *How to make Cognitive Illusions disappear: Beyond Heuristics and Biases*, *European Review of Social Psychology*, 2, pp 83-115, 1991
- G Gigerenzer and D Goldstein, *Reasoning the Fast and Frugal Way: Models of Bounded Rationality*, *Psychological Review* 103, pp 650-669, 1996,
- J Habermas, *On the Constitution of Europe*, Ersatz, 2011
- P Hall and D Soskice, *Varieties of Capitalism*, Oxford University Press, 2001
- L E Harrison and S P Huntington: *Culture Matters: How Values Shape Human Progress* New-York Basic Books, 2000
- F A Hayek, *Studies in Philosophy, Politics, and Economics*, Touchstone, 1969
- F A Hayek, *The Road to Serfdom*, 1944, reprinted by Georg Rutledge and Sons, 2001
- G W F Hegel, *The Philosophy of Right*, trans TM Knox, Oxford University Press, 1967
- D Held, *Democracy and the Global Order. From the Modern State to Cosmopolitan Governance*, Polity Press, 1995
- D Hepstein, *The Political Theory of the Federalist*, University of Chicago Press, 1984
- T Hobbes, *Leviathan*, I 1, ebooks@Adelaide, 2007
- K Hoff, and A Sen: *A Simple Theory of the Extended Family System and Market Barriers to the Poor*. Santa-Fe Institute Conference on Poverty Traps, working paper, 2001
- W Hutton, *The Writing on the Wall*, Little, Brown and Company, 2007.
- D Hume, *A Treatise of Human Nature*, London, in eBook #4705, 1739-1740
- IMF history (no author), *Cooperation and Reconstruction 1944-71*,  
<http://www.imf.org/external/about/histcoop.htm> (on the web 2013-03-02)
- M Kahler and D Lake, *Economic Integration and Global Governance: Why So Little Supranationalism?* in W Mattli and N Woods (ed), 2009
- I Kant, *Foundations of the Metaphysics of Morals*, EGO Books, 2008
- D Kahneman, P Slovic and A Tversky (Eds), *Judgement under Uncertainty: Heuristics and Biases*, Cambridge University Press, 1982
- D Kaufman,  
<http://info.worldbank.org/etools/bspan/PresentationView.asp?PID=2363andEID=1056>, 2008 (on the web 2013-03-02)
- J M Keynes, *The Collective Writings of John Maynard Keynes*, vol 26, (edited), Cambridge University Press, 1980
- J Kuklinski, (ed.) *Citizens and Politics. Perspective for Political Psychology*, Cambridge University Press, 2009
- B Latané and J M Darley, *The Unresponsive Bystander: Why doesn't He Help?*, New-York Appleton-Century-Crofts, 1968
- D Lee, *The Society of Society: The Grand Finale of Niklas Luhmann*, *Sociological Theory* 18:2, July 2000
- J Lindvall and B Rothstein, *Vägar till Välstånd*, SNS Förlag, 2010  
 An English version of the book is to be published at Chicago Press.  
<http://press.uchicago.edu/ucp/books/book/chicago/Q/bo11632847.html>
- J Locke, *Two Treatises of Government*, Ed. Peter Laslett, 1967
- C N Macrae, A B Milne and G V Bodenhausen, *Stereotypes as Energy-Saving Devices : A Peel Inside the Cognitive Toolbox* , *Journal of Personality and Social Psychology* 66, 1994
- I Markova, *Human Awareness. Its Social Development*, Hutchinson, 1987
- R McGregor, *The Party, The Secret World of China's Communist Rulers* Harper Collins, New-York 2010
- R Martin, *Fixing The Game: Bubbles, Crashes, and What Capitalism Can Learn from the NFL*, Harvard Business Review Press, 2011.
- W Mattli and N Woods (ed), *The Politics of Global Regulation*, Princeton University Press, 2009
- F Nietzsche, *On the Genealogy of Morals, A Polemic Tract*, Reprinted by Richer Resources Publications, 1967. Also on <http://www.richerresourcespublications.com/>

- E-Books/philosophic\_titles/Nietzsche/Genealogy\_of\_Morals-an\_excerpt.pdf (on the web 2013-03-02)
- F Norris, Crisis Over, But Where is The Fix?, International Herald Tribune, 11 March 2011, <http://www.nytimes.com/2011/03/11/business/economy/11norris.html?pagewanted=all&r=0> (on the web 2013-03-02)
- R Nozick, Anarchy, State and Utopia, Basic Books, 1974,
- B Obama, The Audacity of Hope. Thoughts on Reclaiming the American Dream, Canongate Books, 2007
- Y Papantoniou, The Lessons of the Euro zone Crisis That Should Shape the EU's G20 Stance, Friends of Europe, Spring 2011
- T Parsons, The Social System, with the Foreword of B S Turner, Mackays of Chatham, Reprinted 1991
- R Peston, Who Runs Britain?, Hodder and Stoughton, London, 2008
- Plato, The Republic, transl. A Bloom, Basic Books, New York, 1968
- A R Poteete, M A Janssen, and E Ostrom, Working Together: Collective Action, the Commons, and Multiple Methods in Practice, Princeton University Press, 2010.
- S Radelet and J Sachs, The Onset of the South East Asian Crisis, in P Krugman (ed), Currency Crisis, University of Chicago Press, 2000
- J Rawls, A Theory of Justice, 1971, reprinted by University Press, 2004
- D Rodrik, The Globalization Paradox, Democracy and the Future of the World Economy W W Northon and Company, 2011.
- E Rothschild, Economic Sentiments. Adam Smith, Condorcet, and the Enlightenment, Harvard University Press, 2001
- R Samuels, S Stich and L Faucher, Reason and Rationality, in M Sintone et.al. Handbook of Epistemology, 1999
- A Sen, The Idea of Justice, Harvard University Press, 2009
- N Sarkozy, Speech at the World Economic Forum 2010, <http://www.cfr.org/financial-crises/sarkozys-speech-world-economic-forum-january-2010/p21346> (on the web 2013-03-02)
- Stanford Encyclopaedia of Philosophy, <http://plato.stanford.edu/entries/equality/> (on the web 2013-03-02)
- E Stein, Without Good Reason, Oxford, 1996
- S Stetter (ed), with Preface by Richard Little, Territorial Conflicts in World Society. Modern Systems Theory, International Relations and Conflict Studies, Routledge, 2007
- J E Stiglitz, Making Globalization Work, Penguin Books, 2007
- W Streeck, The Crises of Democratic Capitalism, New Left Review 71, Sept-Oct 2011
- L Summers, America Needs to Make a New case for Trade, and A Strategy to Promote Healthy Globalization, Financial Times, April 27 and May 4, 2008 (on www.ft.com 2013-03-02)
- D Tapscott, Global Solution Networks for the 21st Century, <http://forumblog.org/2012/10/global-solution-networks-for-the-21st-century/>, 2012 (on the web 2013-03-02)
- C Tavis and E Aronson, Mistakes Were Made (But not by Me), Harcourt Books, 2008
- G Tett, Fool's Gold, Free Press, 2009
- R H Thaler and C R Sunstein, Nudge. Improving Decisions About Health, Wealth and Happiness, Yale University Press, 2008
- Lord Turner, Daily Telegraph, 26 February 2009, p 1 (on www.telegraph.co.uk 2013-03-02)
- D Westen, C Kilts, P Blagov et.al., The Neural Basis of Motivated Reasoning: A fMRI Study of Emotional Constraints on Political Judgment During the US Presidential Election of 2004. Journal of Cognitive Neuroscience 18, 2006.
- D Westen, The Political Brain, Public Affairs, 2007
- M Wolf, Financial Times, 6 April 2011, (on www.ft.com 2013-03-02)
- A S P Woodhouse, Puritanism and Liberty, being the Army Debates (1647-9), the Clarke Documents and Supplementary Documents, 1938. Now also on [http://oll.libertyfund.org/index.php?option=com\\_content&task=view&id=1319&Itemid=287](http://oll.libertyfund.org/index.php?option=com_content&task=view&id=1319&Itemid=287) (on the web 2013-03-02)
- N Woods, The Globalizers. The IMF, the World Bank and Their Borrowers, Cornell University Press, 2006
- Xinhua, China Heads for Slower Growth, China Daily, [http://www.chinadaily.com.cn/china/2011-04/07/content\\_12289265.htm](http://www.chinadaily.com.cn/china/2011-04/07/content_12289265.htm), 2011 (on the web 2013-03-02)