



*Siber Ink*

**This copyright protected work from Siber Ink Publishers is licensed under a Creative Commons Attribution Non-Commercial No-Derivatives 3.0 Licence. In essence, you are free to share it with others provided the original source and author(s) are attributed, no commercial use is made of it, and no derivatives are made from it.**



#### **You are free:**

- to share — to copy, distribute and transmit the work

#### **Under the following conditions:**

- Attribution — You must attribute the work in the manner specified by the author or licensor (but not in any way that suggests that they endorse you or your use of the work).
- Non-commercial — You may not use this work for commercial purposes.
- No Derivative Works — You may not alter, transform, or build upon this work.

#### **With the understanding that:**

- Waiver — Any of the above conditions can be waived if you get permission from the copyright holder.
- Public Domain — Where the work or any of its elements is in the public domain under applicable law, that status is in no way affected by the license.
- Other Rights — In no way are any of the following rights affected by the license:
  - •Your fair dealing or fair use rights, or other applicable copyright exceptions and limitations;
  - •The author's moral rights;
  - •Rights other persons may have either in the work itself or in how the work is used, such as publicity or privacy rights.

#### **Notice**

For any reuse or distribution, you must make clear to others the license terms of this work. The best way to do this is with a link to this web page:

<http://creativecommons.org/licenses/by-nc-nd/2.5/za/>

# Exploring the WFO Option for Global Banking Regulation

by Lawrence G Baxter

Extracted from

## ***Globalisation and Governance***

Edited by

Laurence Boulle

GLOBALISATION  
& GOVERNANCE



EDITED BY  
LAURENCE BOULLE

Published by Siber Ink



*Siber Ink*

Available in different formats from:

**Hard copy**

[www.siberink.co.za](http://www.siberink.co.za)

**Adobe pdf eBook**

<http://www.littlewhitebakkie.com/Globalisation-and-Governance.htm?product=2999>

**Adobe ePub eBook**

<http://www.littlewhitebakkie.com/Globalisation-and-Governance.htm?product=3001>

# 6

## Exploring the WFO Option for Global Banking Regulation

LAWRENCE G BAXTER\*

### 1. INTRODUCTION

Globalisation promised worldwide development and wealth — and threatened new possibilities for harm. The promises and the threats were realised equally within the short time-frame of the first decade of the 21st century. Riding on the great *glasnost* brought about by the World Trade Organization (WTO) and the liberalisation of financial markets in many areas of the world, international trade and international finance accelerated at an impressive pace.<sup>1</sup> So too did the frequency and scale of systemic financial crises around the world.<sup>2</sup>

The 2008 crash that had been waiting for a place to happen was triggered by the subprime mortgage crisis in the United States and eventually culminated in the Great Recession—the second longest American recession of the 20th century.<sup>3</sup> This recession impaired US GDP by 4.1%, wiped out 7.3 million jobs and reduced the average net worth of Americans by 21%. Of course the impact swiftly went global. The

---

\*I am grateful to my colleague, Larry Helfer, for his very helpful suggestions on the revised draft.

<sup>1</sup> On which see generally, for example, Laurence Boule *The Law Of Globalisation: An Introduction* (2009), especially ch 5; Douglas D Evanoff, David S Hoelscher & George Kaufman *Globalisation And Systemic Risk* (2009).

<sup>2</sup> See Michael Bordo, Barry Eichengreen, Daniela Kilingebiel & Maria Soledad Martinez-Peria 'Is the Crisis Problem Growing More Severe?' (2001) 16:32 *Economic Policy* 51 (World Bank paper version, December 2000, available at [http://sitersources.worldbank.org/DEC/Resources/cris\\_problem\\_more\\_severe.pdf](http://sitersources.worldbank.org/DEC/Resources/cris_problem_more_severe.pdf)). See generally Carmen M Reinhart & Kenneth S Rogoff *This Time Is Different: Eight Centuries Of Financial Folly* (2009).

<sup>3</sup> National Bureau of Economic Research, available at <http://www.nber.org/cycles/sept2010.html>. See the graphic accompanying the article by Sara Murray 'Slump Over, Pain Persists' *Wall St Journal*, 21 September 2010, available at <http://professional.wsj.com/article/SB10001424052748703989304575503691644231892.html#articleTabs%3Dinteractive>.

demise of Lehman Brothers on 15 September 2008 instantly triggered the Global Financial Crisis (GFC), with reverberations from the bankruptcy displaying themselves in many countries and freezing the global supply of credit.<sup>4</sup>

The world continues to experience the dire consequences of borderless trade and finance, a gigantic market that is inadequately moderated by mechanisms for controlling the contagion that spreads from financial meltdowns anywhere in the international system. This has left the international community with the perplexing challenge of devising forms of regulation and governance that might ensure that the benefits of globalisation come at less severe cost to financial stability.

## 2. SUPRANATIONAL REGULATOR?

A solution long proposed is to create supranational or global regulatory agencies for supervising international financial institutions.<sup>5</sup> Such proposals, though sometimes still strongly offered and even supported by some senior political leaders, seem to have no chance of success.<sup>6</sup> Economic regulation, particularly as it relates to banking, is a function so close to the heart of the political sovereignty of any nation that it seems almost unimaginable that any country, let alone major groups of nations, would cede so much power to a transnational body — at least not without decades of tortuous negotiations, corresponding uncertainty and regulatory paralysis. Europe itself has struggled to reach agreement on supranational financial regulation and has had to settle for groupings

---

<sup>4</sup>See, for example, Carrick Mollenkamp, Mark Whitehouse, John Hilsenrath & Ianthe Jeanne Dugan 'Lehman's Demise Triggered Cash Crunch Around Globe' *Wall St Journal* 29 September 2008, available at <http://professional.wsj.com/article/SB122266132599384845.html?mg=reno-secaucus-wsj>. This view of what happened is partially challenged in a study by Gara Afonso, Anna Kovner & Antionette Schoar, 'What happened to US interbank lending in the financial crisis?' *Vox*, 26 April 2010, available at <http://www.voxeu.org/index.php?q=node/4941>.

<sup>5</sup>Former British Prime Minister Gordon Brown, in his earlier capacity of Chairman of the International Monetary Fund ministerial steering committee, proposed a World Financial Authority. See Howard Davies & David Green *Global Financial Regulation: The Essential Guide* (2008) 112. See also the authors noted by Lawrence G Baxter 'Internationalisation of Law—The 'Complex' Case of Bank Regulation' in Mary Hiscock and William van Caenegem (eds) *The Internationalisation of Law: Legislating, Decision-Making, Practice and Education* (2010) 3 at 21–22, notes 154–159, and Luigi Spaventa, 'Reforms of the World Financial System: Can the G20 Deliver?', *Vox*, 28 January 2009, available at <http://www.voxeu.org/index.php?q=node/2894>.

<sup>6</sup>Heidi Mandanis Schooner and Michael W Taylor *Global Bank Regulation: Principles and Policies* (2010) 292 ('A global financial regulator would, however, appear to be beyond the realm of practical politics').

of bureaucracy that lack the power to take significant direct action and are dependent on networks of domestic regulators.<sup>7</sup>

### 3. A NEW WFO?

Barry Eichengreen,<sup>8</sup> Peter Boone and Simon Johnson<sup>9</sup> — prominent international economists — have headed in another direction, resorting to a more traditional international law approach. They propose, instead of a supranational regulator, a new global trade in finance treaty, what Professor Eichengreen has proposed calling a World Financial Organization (WFO), and similar perhaps to the current World Trade Organization.<sup>10</sup> Professors Boone and Johnson rather vaguely return, however, to the global regulator theme for enforcing such a treaty:

It would also need to have a body that monitored implementation, similar to the IMF [International Monetary Fund] or BIS [Bank for International Settlements] today. This body would also need to have clear rights to impose new regulations so that rules can be modified to reflect changes in problems.<sup>11</sup>

At present some of the conditions for entry into foreign financial markets are already addressed by the Annex on Financial Services to the General Agreement on Trade in Services (GATS)<sup>12</sup> and, regionally, by numerous treaties such as Chapter 14 of the North American Free Trade Agreement (NAFTA).<sup>13</sup> These treaties do not, however, address in significantly actionable detail the minimum standards for bank capitalisation, liquidity, risk management, regulatory supervision and other ingredients essential for preventing or at least forestalling unsafe banking.<sup>14</sup> Presumably the WFO

<sup>7</sup> For the newest developments as adopted by the European Commission, see the Commission's releases and Q&A at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1347&format=HTML&aged=0&language=EN&guiLanguage=en>, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/404&format=HTML&aged=0&language=EN&guiLanguage=en> and <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/405&format=HTML&aged=0&language=EN&guiLanguage=en>.

<sup>8</sup> Barry Eichengreen 'Not a New Bretton Woods but a New Bretton Woods Process' in Barry Eichengreen & Richard Baldwin (eds) *What G20 Leaders Must Do To Stabilize Our Economy and Fix the Financial System* (2008) 25, available at [http://www.voxeu.org/reports/G20\\_Summit.pdf](http://www.voxeu.org/reports/G20_Summit.pdf).

<sup>9</sup> Peter Boone and Simon Johnson 'Will the politics of global moral hazard sink us again?' in Adair Turner et al *The Future of Finance* (2010) 247 at 269. For some historical context see, for example, Schooner and Taylor, note 6 above at 292–94.

<sup>10</sup> See [http://www.wto.org/english/thewto\\_e/whatis\\_e/whatis\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm).

<sup>11</sup> Boone and Johnson, note 9 above at 269.

<sup>12</sup> See [http://www.wto.org/english/tratop\\_e/serv\\_e/10-anfin\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm).

<sup>13</sup> See <http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpiID=145>.

<sup>14</sup> Indeed, the GATS and associated documents (Financial Annex, Market Access Rules and the additional Understanding on Commitments in Financial Services) may prevent necessary action to avert crises and might already have been widely violated

proposal would envisage more detailed standards as minimum conditions for mutual recognition and enforcement, and that an adjudicatory body similar to the Appellate Body of the WTO would be established to arbitrate disputes. Indeed, in a more recent exploration of the WFO option, Professor Eichengreen proposes the creation of independent panels of experts for determining whether countries are in compliance with their obligations as members of the new organisation; if there is a finding of non-compliance then financial institutions chartered in the offending territory would find themselves restricted in their ability to do business in other member nations.<sup>15</sup>

#### 4. WHY THE WFO OPTION IS NOT VIABLE

The WFO idea is superficially appealing because it might obviate the need for a (politically unrealistic) supranational regulator while also promoting the efficient flow of finance across borders on the basis of minimum safety standards. In my view it is misconceived, doomed to failure and, even if I were wrong, would not be the most effective approach to global financial services for the future.<sup>16</sup>

The WFO option misconceives the nature of the problem. Unlike trade regulation, financial regulation deals only in part with specific products, activities and services. Financial and particularly bank regulators must concern themselves with the *ongoing conduct* of specific financial institutions and, more recently, with how their conduct impacts overall financial stability. Prudential standards must be interpreted and applied dynamically, on a daily basis, and within highly situational contexts in which, for example, capital levels or leverage ratios in one month might be acceptable but, in light of sudden losses or systemic instability, might be unacceptable in another. The list of variable circumstances and discretionary considerations applicable to a particular financial institution, group of institutions, or entire domestic or global industry (for example, commercial lending) is perhaps infinite in its range. This is a far cry from and much more nuanced a context than that which obtains

---

by government actions to address the GFC. See for example, Bart De Meester 'The Global Financial Crisis and Government Support for Banks: What Role for the GATS?' (2010) 13 *J Int Econ L* 27; Jayati Ghosh 'The WTO as Barrier to Financial Regulation' *IDEA*, 8 February 2010, available at [http://www.networkideas.org/featart/feb2010/fa8\\_WTO.htm](http://www.networkideas.org/featart/feb2010/fa8_WTO.htm).

<sup>15</sup> Barry Eichengreen 'International financial regulation after the crisis' (2010) *Daedalus* 107, 113–14.

<sup>16</sup> See also Chris Brummer 'How International Financial Law Works (and How it Doesn't)' (2011) 99 *Georgetown L J* available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1542829](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1542829) (discussing the impracticality of a global financial regulator).

in the trade of specific goods, quotas, tariffs, and the like. So the whole enterprise of financial regulation is quite different from trade regulation, and attempts to use the same or similar model would merely create a mismatch of tools and problems.

Secondly, as far as practicality is concerned, another potentially fatal problem is that such an agreement would surely take a decade or more to secure.<sup>17</sup> Major transnational systemic financial crises are already occurring at a more frequent rate and their scale might well be on the rise.<sup>18</sup> As one commentator recently observed, 'We could very well have one or two more crises before these rules even come into play.'<sup>19</sup> We cannot afford to wait while a whole new treaty is negotiated. And even if such a treaty were to be negotiated, trade disputes usually take years to resolve and the delays seldom generate large-scale crises. Financial crises, on the other hand, develop and must be responded to overnight.

Thirdly, the WTO was designed primarily to *open up* markets rather than regulate their ongoing operations. This means that sanctions are easier to apply: membership *itself* is a powerful and prestigious carrot at the national level, and nationally focused trade sanctions for non-compliance a powerful deterrent. In effect, treaties such as the WTO create what Larry Helfer has described as 'club goods,' which can be enjoyed by members of the 'club' but excluded from non-members.<sup>20</sup> On the other hand, excluding *specific* financial institutions that refuse to meet the requirements of any analogue to the GATS, for example exclusion from the WFO, would seriously risk generating more dangerous offshore financial centres (OFCs). Money, unlike goods and many other services, is fungible and more easily disguised, laundered and converted than tangible goods, and its flow is not easily containable. Even the most prestigious of financial institutions have threatened to thwart stricter regulation by departing for more friendly jurisdictions.<sup>21</sup> Though such threats

<sup>17</sup> The current WTO trade negotiation round, the Doha Development Agenda, has itself been under negotiation for more than nine years, yet despite an asserted 'wide-spread and determined commitment,' shows no signs of coming to closure. See [http://www.wto.org/english/news\\_e/news10\\_e/tnc\\_dg\\_stat\\_19oct10\\_e.htm](http://www.wto.org/english/news_e/news10_e/tnc_dg_stat_19oct10_e.htm).

<sup>18</sup> See note 2, above.

<sup>19</sup> Bernard Baumohl, Chief Economist of the Economic Outlook Group, quoted by Joel Schectman, 'New Bank Rules May Not Prevent More Meltdowns' *Newsweek*, 16 September 2010, available at <http://www.newsweek.com/2010/09/16/new-bank-rules-may-not-prevent-more-meltdowns.html>.

<sup>20</sup> Laurence R Helfer 'Nonconsensual International Lawmaking' 2008 *University of Illinois L Rev* 71, 100–103.

<sup>21</sup> These threats have been common lately. See, for example, the threats by British banks to relocate their headquarters if they were to face breakup in Britain: Jon Menon & Andrew MacAskill, 'Banks Likely to Escape Breakup by UK Commission', *Bloomberg*, 23 September 2010 available at <http://www.bloomberg.com/news/2010-09-23/u-k-banks-likely-to-escape-breakup-by-government-commission-analysts-say.html>;

are probably mostly bluff, they do have considerable domestic political influence. Furthermore, if these threats were ever carried out, the technology revolution has driven financial innovation to new heights in which thinly-policed offshore schemes could rapidly infiltrate back into domestic systems and, through the capillaries of international finance, could quickly spread contagion across supposed financial 'boundaries.' To continue the Helfer metaphor, non-members (that is nations and financial institutions that can evade the rules of the club) can still secure the benefits of transborder operations and, in the process, generate negative externalities for everyone.

Finally, if formal international solutions are to be pursued, it should at least be asked whether, as a long-term solution, *amendment* of the GATS to take into account the need for emergency action and better macro- and micro-prudential regulation might be more expedient than pursuing yet another major international treaty. Should one vest broader arbitral power within the existing WTO institutions to address bad faith regulatory actions? Creating a whole new, ultimately competing, WFO would seem to be a palpably less efficient, if not entirely duplicative, approach in a world of global trade that is always facilitated by and runs on the rails of international finance. At the same time, as is evident from discussions concerning the merits of extending the WTO to incorporate broader issues such as labour standards and environmental protection, even this option is problematic.<sup>22</sup>

## 5. STARTING AT HOME?

There is a tendency to confuse different types of crisis. The GFC was not an example of the sovereign default, political, currency, inflation or debt crises that have driven many other regional and international crises.<sup>23</sup> It was a *banking* crisis, triggered by an asset bubble and market and regulatory failure that went global because of the *globalised* nature of the modern financial system. This implies that it was the *agents of market activity* that drove the build-up to the crisis and transmitted its global consequences.

If this view is correct, then it would seem to be more effective to continue to focus on the primary industry and regulatory structure at the *domestic* level before attempting to create a major new international framework. The sources of global financial instability and bank fragility

---

and by the CEO of Goldman Sachs to Europe: Patrick Jenkins & Megan Murphy 'Goldman warns Europe on regulation' *Financial Times*, 29 September 2010, available at <http://www.ft.com/cms/s/0/793cb220-cbf2-11df-bd28-00144feab49a.html>.

<sup>22</sup> See, for example, Andrew R Guzman 'Global governance and the WTO' (2004) 45 *Harv Int'l L J* 303.

<sup>23</sup> See generally Reinhart and Rogoff, note 2 above, 4–14.



really still reside and need to be resolved first at the domestic level. Notwithstanding wide-scale international collaboration in forums such as the G-20, IMF and Bank for International Settlements, some of which will be discussed later, domestic jurisdictions still have much structural revision to do before we will see meaningful regulatory progress at a transnational level.

To try to resolve the problems through new global institutions would involve having the industry drive the framework rather than the other way around: a very fat tail wagging a very undernourished dog. A global framework developed now would merely serve to validate and accommodate the aggressive demands of a competitive and already global banking industry that is not focused on the externalities generated by these activities. The last time we engaged in such an approach to major restructuring was when the Travelers' Group and Citicorp presented regulators with a de facto merger that forced the passage of the Gramm-Leach-Bliley Act of 1999 in the United States — with disastrous results.<sup>24</sup>

Pursuing yet another arduous and complicated treaty would create a diversion from the difficult task of economic and industry reform. Unless and until nations have the fortitude to address the fact that without massive public backing subsidies the very large, complex and global financial institutions (LCFIs) would likely be insolvent, and that for as long as they operate on their current complexity and scale they pose vast risks to financial systems as a whole, we will continue to promote the escalation of global risk rather than diminish it.<sup>25</sup> No amount of international agreement that refuses to acknowledge this basic problem will insulate us from another, rapidly globalised, financial crisis.

So domestic jurisdictions may have little alternative in the face of new crises but to adopt, as we often have,<sup>26</sup> unilateral measures to prevent or at least reduce or minimise the impact of unsafe foreign financial practices within their own systems. As Joseph Stiglitz has observed, 'Watchdogs

---

<sup>24</sup> Not only did the Travelers/Citi merger itself fall apart a few years later but the Gramm-Leach-Bliley Act is blamed by many for precipitating dangerous bank combinations that contributed to the GFC.

<sup>25</sup> For my own views, see Lawrence G Baxter 'Did we tame the beast? Views on the US Financial Reform Bill' (2010) II *J Regulation & Risk North Asia* 209. Many others have expressed similar concerns.

<sup>26</sup> The United States examples are the International Banking Act of 1978 (governing licensing of foreign bank operations in the US); Foreign Bank Supervision Enhancement Act of 1991 (enacted in response to the BCCI debacle and setting standards of consolidated and home country supervision expected by the US of foreign banking organisations operating in the US); and scattered provisions in the recent Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (subjecting US operations of foreign banks, inter alia, to potential financial stability regulation).

need not bark together'.<sup>27</sup> To be sure, such action would be all the more effective if also coordinated at the international level. But we should not be lulled by such coordination efforts into neglecting the critical areas in which our own domestic responses to global finance might be improved.

## 6. WHAT ARE THE DOMESTIC AREAS REQUIRING GREATER FOCUS?

### (a) Industry scale, scope and complexity

The most fundamental challenge is to devise the proper size and scope of financial institutions for optimal safe operation, given the complexity of their risks and the capacity for their meaningful regulation. This challenge was posed but ultimately avoided in the United States, even though many senior policy-makers, regulators and commentators believe that it must ultimately be addressed. The Independent Banking Commission (ICB) has raised it again in the United Kingdom and the ICB is to be congratulated for having the courage to renew such basic questions in the face of vigorous industry opposition.<sup>28</sup>

The global economy, as much as domestic economies, is very vulnerable to the collapse of another gargantuan financial institution. Can we really afford the risk of \$2–3 trillion, highly complex (and relatively inefficient) LCFIs without adequate assurances that they can be safely managed and regulated? Such assurances are not to be found beyond the realm of mere assertion. Like all fundamental reform, it is unlikely that this challenge will be met before another crisis creates the political will to do so.

### (b) Continued development of better general intelligence gathering, analysis and detection of global hot spots of dependency

The complete failure to detect the growing dependence of the larger financial system upon the credit default swap market, led primarily by AIG, provides an example.<sup>29</sup> Such trends are reported and easily monitored; yet action came far too late. Similarly, the dangerous growth in

<sup>27</sup> Joseph Stiglitz 'Watchdogs need not bark together' *Financial Times*, 9 February 2010, available at <http://www.ft.com/cms/s/0/3ebddd1e-15b7-11df-ad7e-00144feab49a.html#axzz1CyZzIkRC>.

<sup>28</sup> See Independent Commission on Banking 'Issues Paper: Call for Evidence' 24 September 2010 available at <http://bankingcommission.independent.gov.uk/bankingcommission/wp-content/uploads/2010/07/Issues-Paper-24-September-2010.pdf>.

<sup>29</sup> The final word on the AIG affair is not yet out, but a convenient collection of testimony, charts and graphs is to be found in the record of the Financial Crisis Inquiry Commission for its hearing into the role of derivatives in the Financial Crisis, available at <http://www.fcic.gov/hearings/06-30-2010.php#documents>.

leverage among international investment banks, in particular, and the rapid decline in bank capital necessary to meet the misconstrued standards of Basel II, could and should have become a central concern of domestic regulators long before it did. How do we adapt to the reactions of industry when new regulations are imposed? The progress and effectiveness of new institutions such as the US Financial Stability Oversight Council and the new European Systemic Risk Board should be observed before we try to create even grander (and indubitably more cumbersome) bureaucracies.

Economists and lawyers also have much work to do to get with the program and move beyond formal doctrine and models to a better understanding of system dynamics. In the case of the lawyers, Thomas Cottier has rightly observed, international economic law practitioners have 'left the monetary part of the equation largely outside their radar screen and field of interest,' and in the process have become 'virtually without voice in the aftermath of the banking crisis.'<sup>30</sup>

**(c) Rapid domestic response plans that enable LCFIs and regulators to trigger circuit breakers as crises begin to erupt in other domestic economies**

This task involves developing a different approach to regulation from the traditional one of command and control. Regulators are and always will be embroiled within a rapidly innovating, evolving and labile complex adaptive system that requires systems thinking.<sup>31</sup> This thinking might entail the adoption of principles such as modularity.<sup>32</sup>

I realise that these suggestions take us into treacherous and controversial waters that might permit domestic regulators to apply various principles from ring-fencing<sup>33</sup> to uncoordinated local receiverships in order to prevent or retard the spread of financial contagion.<sup>34</sup> They risk reviving requirements, disliked by LCFIs, such as local subsidiary formation and liquidity requirements as necessary elements of safe entry into

<sup>30</sup> Thomas Cottier 'Challenges Ahead in International Economic Law' (2009) 12 *J Int Econ L* 3 at 8.

<sup>31</sup> See, for example, Baxter, note 5 above *passim*, and Baxter, note 25 above at 217.

<sup>32</sup> See, for example, Andrew G Haldane 'Regulation or prohibition: The \$100 billion question' (2010) II *J Regulation & Risk North Asia* 101, 110 and following.

<sup>33</sup> See, for example, Schooner and Taylor, note 6 above, 255.

<sup>34</sup> The United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency (1997) Art 13(1), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html), which does not necessarily apply to financial institution insolvency regimes, would prohibit such an approach. For general discussion, see Douglas W Arner & Joseph J Norton 'Building a Framework to Address Failure of Complex Global Financial Institutions' (2009) 39 *Hong Kong L J* 95, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1374126](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1374126).

domestic markets. Issues of fairness to creditors and customers also arise. Yet greater regulatory focus on the deployment by financial institutions of other internal circuit-breakers could also be a necessary, albeit unwelcome, element to the kind of rapid response, or sense-and-respond regulation, that I suspect will shape the future of global financial regulation.<sup>35</sup>

**(d) Tougher, closely supervised infrastructural conduits for regulating the flow of financial transactions — building robustness into financial market utilities (FMUs)<sup>36</sup>**

While it is not always possible to force private and ‘offshore’ pools of capital to channel their transactions and clearing through such exchanges, the stronger and more visible these exchanges become the easier will it be to isolate, and identify for what they are, the potentially dangerous activities of such operators and to impose domestic limitations on financial institutions that do business with them. Maverick OFC ventures might thereby be more easily exposed to higher risk-pricing on their activities and capital.

## 7. RISKS OF PROTECTIONISM?

In promoting the idea of further domestic activity we must avoid a return to pure protectionism, which is all too tempting given the superior economic power of the nations most impacted by the GFC.<sup>37</sup> Developing domestic responses always run this risk. But unilateral action, conducted in concert with close international engagement and consultation along the lines presently offered by the G-20, FSB and Basel Committee, need not be protectionist any more than taking personal responsibility for securing one’s home need be regarded as an act hostile to one’s neighbours.

---

<sup>35</sup>The Basel Committee has issued a thoughtful final report, Report and Recommendations of the Cross-Border Bank Resolution Group (March 2010), available at <http://www.bis.org/publ/bcbs169.pdf>.

<sup>36</sup>In the United States the Dodd-Frank Act, note 26 above, institutes a new regulatory regime for FMUs: see Title VIII (‘The Payment, Clearing, and Settlement Supervision Act of 2010, §§ 801 and following). See generally Anna L Paulson & Kirstin E Wells, ‘Enhancing financial stability: The case of financial market utilities’ 279 *Chicago Fed Letter*, October 2010, available at [http://www.chicagofed.org/digital\\_assets/publications/chicago\\_fed\\_letter/2010/cfloctober2010\\_279.pdf](http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2010/cfloctober2010_279.pdf).

<sup>37</sup>Consider Anne van Aaken & Jürgen Kurtz ‘Prudence or Discrimination? Emergency Measures, The Global Financial Crisis and International Economic Law’ (2009)12 *J Int Econ L* 859; Eilis Ferran *Capital Market Openness After Financial Turmoil*, Working Paper, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1436143](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1436143).

## 8. INTERNATIONAL COORDINATION

International coordination has become much more sophisticated in recent years and is clearly essential. Anne-Marie Slaughter and others have emphasised the significance of the modern evolution of transnational regulatory networks (TRNs).<sup>38</sup> These organisations include the Basel Committee,<sup>39</sup> created by central bankers under the auspices of the Bank for International Settlements, and the Financial Stability Board,<sup>40</sup> created by the G-20 out of the G-8's former Financial Stability Forum. Such organisations facilitate negotiations and international agreements on minimum standards of capital and governance of internationally active banks and the bases for cooperation and rapid exchange of supervisory information between domestic financial regulators. A prominent example was provided in November 2010 when the G-20 summit in Seoul, South Korea, approved the Basel III proposals<sup>41</sup> on minimum capital levels and other bank regulatory mechanisms.<sup>42</sup>

Slaughter and her followers celebrate analogous preceding developments as solutions to the 'global paradox': '[w]e need more government on a global or regional scale, but we don't want the centralization of decision-making power and coercive authority so far from the people actually to be governed'.<sup>43</sup> TRNs, it is argued, provide the solution since they enable complex decisions to be delegated to bureaucrats and technocrats who are themselves ultimately politically accountable to domestic institutions because their decisions still require the internal sanction of such institutions.<sup>44</sup>

Although Slaughter's premises are somewhat controversial,<sup>45</sup> the TRN model has provided, and does provide, a means by which exceptionally

<sup>38</sup> Anne-Marie Slaughter *A New World Order* (2004). For the progenitor of this work, see Robert Keohane 'The Analysis of International Regimes: Towards a European-American Research Programme' in Volker Rittberger and Peter Mayer (eds) *Regime Theory and International Relations* (1995) 23.

<sup>39</sup> Basel Committee on Banking Supervision, available at <http://www.bis.org/bcbs/index.htm>.

<sup>40</sup> See <http://www.financialstabilityboard.org/>.

<sup>41</sup> See <http://www.bis.org/bcbs/basel3.htm>.

<sup>42</sup> See the G-20 Summit Declaration, 11–12 Nov, available at [http://www.g20.org/pub\\_communiques.aspx](http://www.g20.org/pub_communiques.aspx).

<sup>43</sup> *Ibid* at 8.

<sup>44</sup> It might now be argued that the provisions in the so-called 'Collins Amendment' contained in the Dodd-Frank Act, note 26 above, §§ 171 and 175, which require regulators to set leverage and risk-based capital requirements and engage in international policy coordination, effectively provide legal and democratically accountable endorsement of the Basel and FSB processes.

<sup>45</sup> See, for example, Pierre-Hugues Verdier 'Transnational Regulatory Networks and Their Limits' (2009) 34 *Yale J Int L* 113; Kenneth Anderson 'Squaring the circle? Reconciling Sovereignty and Global Governance Through Global Government Networks (Review of Anne-Marie Slaughter, *A New World Order*)' (2005) 118 *Harv L Rev* 1255.

complex and complicated regulatory issues requiring international coordination are being addressed. Despite the fact that their work failed utterly to prevent the GFC, the causes really began at home not in Basel, and were globalised as a result of the *global nature* of our financial institutions. We should be careful not to dismiss or diminish the importance of and significant progress made by TRNs as a more practical means of promoting global coordination and stability than any future global treaty, particularly once we have had the courage first to solve more satisfactorily the underlying domestic problems relating to financial industry structure and its regulation.

# GLOBALISATION & GOVERNANCE



EDITED BY  
**LAURENCE BOULLE**

# GLOBALISATION AND GOVERNANCE

*Edited by*

LAURENCE BOULLE

2011



*Siber Ink*



First published 2011

by



*Siber Ink*

PO Box 30702  
Tokai 7966  
Cape Town  
SOUTH AFRICA

[www.siberink.co.za](http://www.siberink.co.za)

© Siber Ink CC

ISBN 978-1-920025-39-7

This book is copyright under the Berne Convention. In terms of the Copyright Act 98 of 1978 no part of this book may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording or by any information storage and retrieval system, without permission in writing from the Publisher.

Typesetting by G.J. du Toit  
Index by Penny Smorenburg

Printed and bound by  
Creda Communications, Cape Town

# Preface

The Mandela Institute at the School of Law in the University of the Witwatersrand, Johannesburg, was established to develop knowledge and capacity relevant to the involvement of South Africa, the region and the continent of Africa in the competitive global economy. The Institute conducts short courses, continuing professional development courses, workshops and seminars for government, industry, the professions and community organisations.

The Institute also conducts public conferences on subjects within its brief. For the last five years it has run an annual competition law conference, in conjunction with the South African Competition Commission. A few years ago it held a conference on International Trade and Development in Africa and at the time of writing is organising the first Africa-wide conference on international economic law, in conjunction with the Society of International Economic Law (SIEL) and the World Trade Institute.

In September 2010 lawyers and economists, government, industry and the professions, and community organisations and NGOs participated in a conference on Globalisation and Governance. A selection of the articles based on conference papers has been chosen for this book to reflect diversity in the topic, from high theory to raw practicality. An attempt has been made to include contributions from different disciplinary perspectives, different jurisdictions and different levels of professional status.

Acknowledgment and thanks are due to the principal sponsors of the conference on which this book is based, the Konrad Adenauer Stiftung and in particular Dr Werner Böhler and Ms Nancy Msibi of the KAS Johannesburg office. Support was received with gratitude from the Swiss Embassy in Pretoria, the World Trade Institute in Bern, Juta Publishers in Cape Town and Webber Wentzel Attorneys in Johannesburg. Thanks are also extended to the Research Office and Faculty of Commerce, Law and Management at Wits University for their support.

I should like to thank my colleagues at the Mandela Institute for their assistance with the conference and support for this book. This goes firstly to Julie Dunsford, organiser extraordinaire, to Michelle Scorgie-Gallant, Irma Cheval, Nokuhle Madolo and Magda Janse van Noordwyk, and to Palissy Kengne and Neo Phetoane. Particular thanks go to Henry Gotosa and Azwimpheli Langalanga, interns in the Institute, for patiently assisting with editing, checking and otherwise bringing the manuscript to readiness.

Outside the Institute thanks go to Jonathan Klaaren, Acting Head of School, and Kathy Munro, Acting Dean of the Faculty, for their support, and to Loyiso Nongxa, Vice-Chancellor, at Wits for lending various kinds of support to the conference. It has been a good experience to collaborate again with Simon Sephton from Siber Ink and have him commit to also producing an e-version of this book.

Where it has been feasible contributors have taken account of events between the conference and January 2011.

LAURENCE BOULLE

*Editor*

# Contents

PREFACE . . . . .	v
CONTRIBUTORS . . . . .	xi
<b>1. Introduction: Governance in a Globalisation Era . . . . .</b>	<b>1</b>
LAURENCE BOULLE	
1. Introduction . . . . .	1
2. Basic concepts . . . . .	3
3. Aims and attributes of quality governance . . . . .	8
4. Issues in global governance . . . . .	14
5. Issues in state governance . . . . .	19
6. Issues in corporate governance . . . . .	23
7. Collaboration and competition in governance systems . . . . .	25
8. Challenges to governance . . . . .	27
9. Conclusion . . . . .	30
<b>2. Global Economic Governance: The Search for Economic Justice in a Globalised World . . . . .</b>	<b>33</b>
TREVOR MANUEL	
1. Introduction . . . . .	33
2. Steps in global governance . . . . .	34
3. Reform in global governance . . . . .	37
4. Checks and balances in governance . . . . .	38
5. Economic equality and equity . . . . .	40
6. Conclusion . . . . .	42
<b>3. Globalisation Challenges Facing Developing Countries . . . . .</b>	<b>43</b>
D M DAVIS	
1. Introduction . . . . .	43
2. A tentative menu of challenges . . . . .	47
3. The challenge of the financial crisis . . . . .	48
4. Conclusion . . . . .	51
<b>4. Governing Complexity . . . . .</b>	<b>55</b>
MARK A CHINEN	
1. Introduction . . . . .	55
2. Complexity theory: some concepts and their application . . . . .	56
3. Governing complexity: governing under uncertainty . . . . .	59
4. Governing values . . . . .	64
5. Participation in financial governance . . . . .	72
6. Conclusion . . . . .	80

<b>5. The Province of Constitutionalism Undetermined: From the Fall of State Constitutionalism to the Rise of Panlegalism? . . . . .</b>	<b>81</b>
GUILLAUME TUSSEAU	
Introduction . . . . .	81
PART I: TODAY'S CONSTITUTIONALISM . . . . .	83
1. State constitutions disqualified. . . . .	84
2. Constitutionalism without the state. . . . .	87
PART II: ESTABLISHING PERPETUAL LEGAL MOTION? . . . . .	95
1. The self-sustained rhetoric of principled jurisprudence. . . . .	95
2. A strategic reading of the metaphor of constitutional 'dialogue' . . . . .	98
3. Global constitutionalism as an insurance policy for established intellectual and political hierarchies? . . . . .	108
<b>6. Exploring the WFO Option for Global Banking Regulation . . . . .</b>	<b>113</b>
LAWRENCE G BAXTER	
1. Introduction . . . . .	113
2. Supranational regulator? . . . . .	114
3. A new WFO? . . . . .	115
4. Why the WFO option is not viable. . . . .	116
5. Starting at home? . . . . .	118
6. What are the domestic areas requiring greater focus? . . . . .	120
7. Risks of protectionism? . . . . .	122
8. International coordination . . . . .	123
<b>7. Private Dispute Resolution as an Instrument of Governance . . . . .</b>	<b>125</b>
JEFF WAINCYMER	
1. Introduction . . . . .	125
2. What do we mean by governance? . . . . .	126
3. Globalisation and governance . . . . .	127
4. Fragmentation . . . . .	129
5. What is private dispute settlement? . . . . .	133
6. Alternative dispute resolution (ADR) as private dispute settlement . . . . .	136
7. International arbitration . . . . .	136
8. Investment arbitration . . . . .	138
9. Investment law norms. . . . .	152
10. Conclusions. . . . .	156
<b>8. Prospects of Legal Redress for Victims of Corporate Human Rights Violations in a Globalised World. . . . .</b>	<b>158</b>
ROBERT GRABOSCH	
1. Introduction . . . . .	158
2. Advantages of legal proceedings in the global north. . . . .	160
3. Criminal liability. . . . .	160

4. Tortious liability . . . . .	164
5. Non-legal tools with legal consequences: codes of conduct, unfair competition and consumer protection . . . . .	170
6. Conclusion. . . . .	173
<b>9. Institutional Investment and the Protection of Human Rights:</b>	
<b>A Regional Proposal . . . . .</b>	174
BONITA MEYERSFELD	
1. Introduction . . . . .	174
2. My proposal. . . . .	177
PART I: INSTITUTIONAL INVESTORS AS HUMAN RIGHTS REGULATORS . . . . .	180
1. The meaning of institutional investment. . . . .	180
2. The meaning of responsible investment. . . . .	181
3. The history of institutional investment and human rights . . .	182
4. Methods of influence by institutional investors . . . . .	185
5. The business case for SRI. . . . .	186
PART II: REGULATING THE REGULATORS: VOLUNTARY AND LEGAL STANDARDS. . . . .	191
1. Voluntary standards for institutional investment and human rights . . . . .	191
2. Regulation of SRI in national legal systems . . . . .	194
3. The UN, multinational corporations and human rights . . . . .	198
PART III: REGIONAL PROWESS, INSTITUTIONAL INVESTORS AND HUMAN RIGHTS . . . . .	200
1. State responsibility and the SADC perspective. . . . .	200
2. The integration of institutional investment and human rights standards in the SADC region. . . . .	201
3. Requiring a due diligence process in SADC . . . . .	203
4. Difficulties. . . . .	205
5. Conclusion. . . . .	206
<b>10. The European Court of Human Rights' Evolving Approach to Non-Governmental Organisations. . . . .</b>	207
ANNA DOLIDZE	
1. Introduction . . . . .	207
2. Emergence and implications of NGOs . . . . .	212
3. NGOs and the European Court of Human Rights . . . . .	216
4. Conclusions. . . . .	231
<b>11. From Brazil's CDF to Kyoto's CDM: Revisiting Equity Issues in Global Climate Governance . . . . .</b>	236
GODWELL NHAMO	
1. Introduction . . . . .	236
2. Equity in global climate governance . . . . .	237

- 3. From CDF to CDM and the Copenhagen cul de sac . . . . . 246
- 4. Climate equity and trade issues . . . . . 250
- 5. Conclusion. . . . . 251
- 12. Violent Service Delivery Protests in Global Perspective:**
- Issues of Governance in Post-Apartheid South Africa . . . . . 252**
- MAKHOSINI LUCKY KUNENE & JONATHAN OSHUPENG MASENG
- 1. Introduction . . . . . 252
- 2. A theoretical framework . . . . . 254
- 3. Globalisation, neo-liberalism and South Africa's quest for a developmental local government . . . . . 256
- 4. Key issues in service delivery protests in South Africa. . . . . 257
- 5. Contextualising violence in service delivery protests . . . . . 261
- 6. Voices of protest and change in Africa — recent protest experiences . . . . . 263
- 7. Conclusion. . . . . 265
- BIBLIOGRAPHY . . . . . 267
- INDEX . . . . . 271

# GLOBALISATION & GOVERNANCE

EDITED BY

LAURENCE BOULLE



Laurence Boule is Director, Mandela Institute, and Issy Wolfson Professor of Law, University of the Witwatersrand, Johannesburg, and Professor of Law, Bond University, Australia. He has published extensively in constitutional law, mediation and ADR, and international economic law and in late 2009 published *The Law of Globalisation* (Kluwer Law, The Netherlands).



MANDELA INSTITUTE

ISBN 978-1-920025-39-7



9 781920 025397

As countries come to terms with the global financial crisis, their citizens become more assertive in many parts of the world. Challenges to conventional wisdom on economic governance are accompanied by the popular rejection of archaic systems of state government. At the global level new economic and political forces challenge former patterns of international domination.

In these contexts appropriate governance is the imperative of the age. Economic globalisation in particular requires reassessments of state and corporate governance, as well as reconsideration of how the international political economy is governed — or not governed.

This book examines these themes from different disciplinary perspectives, in different national and institutional settings, and in terms of high theory and practical service delivery. It is topical and insightful and provokes thought on the governance challenges ahead.

*“Increasing complexity of technology and production, combined with increasing globalisation, present a major challenge to traditional government and governance structures. This fascinating volume provides a set of incisive, perceptive, and innovative chapters analysing many critical facets of this challenge. It not only provides an important advance in the discourse on globalisation and governance, but also adds an African voice to the discourse.”*

Joel P. Trachtman, Professor of International Law, The Fletcher School of Law and Diplomacy, Massachusetts, USA.

2011



Siber Ink

PUBLISHED BY SIBER INK  
PO BOX 30702, TOKAI, 7966  
CAPE TOWN, SOUTH AFRICA