UNDERSTANDING GLOBAL GOVERNANCE

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IT WAS around half a century ago when Harvard University professor Thomas Schelling published a book entitled *The Strategy of Conflict* (1960). Schelling wrote that whether and how potential players participate in a game depends both on their common and conflicting interests.

To explain the co-existence of these two, Schelling gave an example: Two players can share $100 as long as the sum of their expected amounts is smaller than or equal to $100. So, in order to get at least some of the $100, the two must cooperate. This is the common interest of the two players. However, one may get more and the other will thus get less. This is the conflicting interest of the two players. In other words, the game they play is a zero-sum one. This is very common in life: even though you aim to maximize your own interests, it is also wise to take into account the other party's interests.

GLOBAL ISSUES

Common and conflicting interests exist not only among individuals, but also among sovereign states or other types of organizations whose aim is to maximize their particular interests. Global issues—such as peaceful coexistence, climate change, a fair and open trade system, cyber-security, cross-border crimes including terrorism, money laundering, and a stable international monetary or financial architecture—are all vital to the wellbeing of humanity.

No single country or group of countries can address these issues alone, thus making international cooperation necessary. Every country is a stakeholder in this process and, thus, all countries have common interests. However, addressing these issues involves both cost and benefit sharing—there is no such thing as a free lunch. Once cost and benefit sharing are involved, stakeholders will have conflicting interests, and fierce bargaining becomes inevitable.

GLOBAL PUBLIC GOODS

Addressing these issues is similar to the provision of public goods, thus complicating the matter. Since global public goods—such as maintaining peace and controlling climate change—are not exclusive to a specific country, nations are naturally incentivized to become free riders, leaving other countries to bear the costs of public goods.

As a result, there is a shortage of global public goods, which is well evidenced in the breakout or escalation of wars and unrestricted emissions of carbon dioxide. All of these issues damage the overall wellbeing of humanity. To explain this kind of phenomenon, many concepts or theories have been advanced, including the collective action problem, the prisoner's dilemma, market failure, the tragedy of the commons, and the fallacy of composition.

GLOBAL GOVERNANCE

To address these increasingly serious global issues, international cooperation is required. A common approach is to call for the establishment of a central and authoritative world government that is authorized to levy taxes, acquire resources, and provide public goods globally. However, under current conditions, it is impossible to establish such a system. As a substitute for this missing world government, global governance has emerged.

In essence, global governance is a sum of institutions—either rules or organizations—established by state or non-state actors with the intent of addressing global issues. The creation of these institutions is based on consensus reached by stakeholders through negotiation after they have balanced their common and conflicting interests. The fundamental function of global governance lies in the provision of global public goods.

STAKEHOLDING INTENSITY AND PLAYERS' CAPACITY

There is a long list of global issues, but the importance of a specific global issue varies greatly by actor.

A typical example is the United Nations Convention on the Law of the Sea, which has varying significance to coastal countries and landlocked states. Actors also have hugely differing sizes and negotiating power, which is a key factor in determining the depth and breadth of their involvement in global governance. They—especially state actors—have different internal political structures and decisionmaking mechanisms, and their social cohesion and stability are also different.

The interests or values held by huge multinationals, whose total assets can be equal to those of a country, or influ-

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ential religious groups, play an essential role on the world stage.

This explains why global governance takes different forms, achieves different results, and is either non-existent or inadequate. It also explains why, in such a context, it is difficult to reach a consensus and take collective action.

Logic of Collective Action

Mancur Olson, one of Schelling's students who later became his colleague, is a great contributor to the concept of collective action. Five years after Schelling published *The Strategy of Conflict*, Olson published his doctoral thesis, *The Logic of Collective Action* (1965), under Schelling's guidance. In this book, Olson developed some of Schelling's concepts further.

One of his major arguments was that common interests are only a necessary condition, not a sufficient one, for collective action. Another was that collective action only happens when two conditions are satisfied: first, that there are only a small number of players, and second, that selective incentives are in place. According to Olson, selective incentives work when players can accrue more benefits through participating in collective action, and may incur higher opportunity costs, or even penalties, if they do not participate. If only a few individuals participate in a game, the selective incentives will be reinforced, as each individual can get a larger share from the output of the collective action and the contribution made by each individual can be more easily identified. In other words, if there are fewer participants, it is less costly to reach a consensus and take action collectively. This will reduce the free riding behavior.

Non-neutral Institutions

As mentioned above, the goal of global governance is to provide global public goods. Some global public goods are in short supply, due to the failure of the global governance market. Some, however, are in a surplus. An example of the latter is discriminatory international trade and investment rules.

The rationale behind these can be found in Olson's aforementioned *The Logic of Collective Action*: if incentives are insufficient and a world government is not in place, a few conscientious and capable players who care the most about common issues may take collective action, actively providing public goods that can either bring them net benefits or minimize their losses. If narrow interest groups—those that are driven by selective incentives—take a dominant role, then global governance, in the form of certain international institutions, is likely to be non-neutral or discriminatory.

Dominant players may, thus, use these non-neutral public goods to attain more benefits at the expense of the interests of most stakeholders. Here, non-neutral international institutions in fact serve as the tools of some interest groups to realize their own goals.

Representativeness and Effectiveness

Given that it is extremely difficult to take collective action worldwide—especially as the world is, in essence, a market-like environment dominated by a few players—most collective action involving global governance is small-scale. The G7 can serve as a typical example.

Another example of an attempt at small-scale global governance is the emergence of regional governance systems. Regional governance systems, launched by major players, emerge constantly. This might cause tension between incentives and justice, and raises questions regarding how to strike a balance between effectiveness and representativeness in global governance discussions.

Whether we can address this challenge successfully depends on the vision, wisdom, and courage of all parties—especially the major players.

China's traditional mindset works quite well in this case, as it holds that there is always a middle ground; there is no absolute black or white; and all stakeholders' needs should be considered during negotiations on global rules.

Equilibrium Governance

While thinking about global governance, we need to consider the criteria used for evaluation. When the contribution made by each player to provide global public goods is marginally equal to the benefits each can obtain, global governance is in an equilibrium or ideal state. The reason is that, at such a point, every player maximizes the benefits that can be gained from the provision of public goods. In the vocabulary of the theory of mechanism design in economics, the concept of governance equilibrium is equivalent to incentive compatibility.

Within such an international regime, the problems of free riding, moral hazard, and adverse selection—which hold up the formation of collective action for common interests—would disappear. Although it is very difficult to achieve the goal of equilibrium governance in reality, the ideal state can function as a theoretical reference point to help us assess the performance of global governance, while indicating directions and ways to improve both the quality and quantity of global public goods. In principle, all players must strive to bring global governance as close as possible to a state of equilibrium.

From Selective to Compatible

In today's world, both the absolute and relative power of major global players has changed greatly, even when compared to the recent past. This is giving rise to what is termed a power shift.

Since the world is becoming more and more interconnected, existing international institutions are of greater interest to various players. Thus, there are roughly two groups of players with divergent desires: those who have vested interests and hope to maintain what they have already obtained through the established modalities of global governance; and those who are substantially aware of the gains and losses brought about by non-neutral international institutions and expect to reap the benefit from altering the status quo. It is worth noting that the latter category—namely the one that used to play a peripheral role in world politics—has become indispensable to global governance.

Against this backdrop, we must underscore that there is an increasing need to adjust existing international rules and make global institutions as neutral as possible. Staying updated with the times and substituting selective incentives with compatible ones seems to be an effective approach to making the existing and future global governance system more legitimate and effective.

International Organizations and their Performance

The major providers of global public goods are international organizations jointly established by sovereign states. These include the United Nations, the World Trade Organization, the International Monetary Fund, and the World Health Organization.

Once an international organization is established, stakeholders become concerned about whether it functions well and efficiently. Since the outbreak of the most recent global economic crisis, though, it has been argued that some international organizations failed to do a good job in pre-crisis warning and post-crisis management. The fact that a number of critiques which have been put forward are reasonable indicates that there is still room for improvement in the provision of global public goods. It is therefore necessary to improve both the rules of procedure and the decisionmaking processes of international organizations, along with increasing their decision execution efficiency and optimizing their performance evaluation system. The overall aim of such reforms would be to prevent them from becoming too bureaucratic, as well as minimizing their rent-seeking behaviors. This is an important way to achieve equilibrium governance—both for countries that act as the principal stakeholders and the international organizations themselves that act as the agent.

Enriching Economic Thinking

In *The Strategy of Conflict,* Schelling mentioned a phenomenon long ignored by mainstream economics: creating and destroying wealth and order is a highly asymmetric process. In his estimation, a worker with a high school diploma can only make tens of thousands of dollars a year. But he or she is also capable of destroying wealth that is worth thousands of times more than he or she can earn. If this worker can attain a small portion of the wealth that he or she can destroy by threats, that person can become a blackmailer. Schelling's reminder is indeed necessary, as there are some players who could destroy the world or endanger humanity in a certain way.

It would be a great contribution to humanity if we could make these players—such as brutal terrorists—follow rules and behave in an appropriate manner in a fair and effective global governance system. It would also be a meaningful contribution to the social sciences disciplines if we could generate valuable outputs while applying economics to the analysis of global governance.

Vision

Countries are becoming more interdependent than ever before in human history. The issues we face are global, and addressing them requires global cooperation. It is true that each country has its own interests. However, to paraphrase European Union founding father Jean Monnet: we do not sit on opposite sides of the table, but on the same side, because we are addressing common issues that we all face. Sometimes we need to make deals to take collective actions; but we should aim higher.

Two thousand years ago, Confucius once worded: establish and let establish, develop and let develop. A modern Chinese philosopher Mr. Zhao Tingyang has, in his A Political World Philosophy in terms of All-under-heaven (Tian-xia), coined it as a Confucian improvement, an oriental wisdom on a par with Pareto improvement in the western context. It leads us to beleive that no country can be fully established and developed while others are not; to go forward is to go together.