Chapter 2
Globalization, Nation-States, and Global Governance

Nation-States, Globalism, Globalization

In this chapter, we summarize the general direction of the book and present the premises on which our arguments developed in the following chapters are based on. In doing so, we try to overlook our political predilections that may tint our analysis or our citations, so we can present impartial and balance perspective of the current state of the world. While we cannot possibly claim to have found the full explanation to the questions or the issues discussed in this chapter, our arguments sketch a perspective or a line of inquiry in the study of globalization that may provide a different perspective.

The most natural place to start our discussion is with the notions of "nation" and "nation-state." For one thing, the nation is a modern idea that is highly charged politically, just like the revolutionaries of nineteenth century who yearned for "freedom," the call for nationalism was the driving force of the process of decolonization in the twentieth century.[1] And yet, defensive posters caused the various national movements of the end of twentieth century. They are built through inward reflexes, a phantom fear of the outside world, in which ironically they cannot escape. One can look at the world today and realize that the idea of nation often survive only by allying itself with forces that have undermined its very essence such as religion, ethnicity, ideology, and the tribe, instead of its geological history. It is, therefore, hardly surprising that nationalist impulses during this period should be viewed as

[1] Looking back at the past two centuries, it seems like no one had questioned the link between independence and liberty in a sense that independence would not always accompany liberty for various nations who sought them.

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divisive, xenophobic, if you would, rather than conspiratorial or imperialistic intent.[2] Moreover, in the landscape of the prevailing global system battered by various financial cries of the past several decades, one of the main traditional functions of nation-state, i.e., control over its national economic affairs, is increasingly being divorced from its national dimension and command to the extent that it seems to evoke the demise of nation-states. This is a significant development especially during the epoch in which the state of Union of Soviet Socialist Republics disintegrated into multiple states under the pressure of nationalism, Germany reestablished itself as a nation-state and in Middle East (Palestinian nation), South East Asia (Tamil Tiger nation) and Europe (former Yugoslavia), ethnic cleansing is either in process or has already occurred.

Consequently, these concepts are not only relevant to the content of this book and bear significant in our analysis, but they continue to be defined and redefined, sometime contradictory, by the leading scholars and authors on the subject matters, and heir to the vast tradition of liberal historiography, social science and even English literature.[3]

A nation, according to Jean-Marie Guehenno, "defines itself first by what it is not: it is not a social group, it is not religious group, and it is not a racial group; in other word, what bind together the citizens of a nation is the product of a unique combination of historical factors, and can never be reduced to a single dimension, whether social, religious, or racial."[4] Guehenno further elaborates that the idea of nation "brings people together not for what they are but for the memory of what they have been."[5] In this respect, for him, nation has no other definition but "the locus of a common history, of common misfortunes, and of common triumphs." For Hugh Seton-Watson, "…a nation exists when a significant number of people in a community consider themselves to form a nation, or behave as if they formed one."[6] Benedict Anderson, used the Watson's definition and defined a nation as an *imagined community* in a sense that "members of even smallest nation will never know most of their fellow-members, meet them, or even hear them, yet in the minds of

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[2] The reader should note that while various national movements in the third world were perceived as important allies for the Communist Internationalists, the fact is that the Communists did not support the "nationalism of the oppressed" as an end in itself. In this regard, Lenin captured the point when he stated, "If we demand freedom of secession for the Mongolians, Persians, Egyptians, and all other oppressed and unequal nations without exception, we do so not because we favor secession, but only because we stand for free, voluntary association and merging as distinct from forcible association. That is the only reason." See V. Lenin, A Caricature of Marxism and Imperialist Economism, Moscow, 1974, p. 47.

[3] "What is it? Says John Wyse. A nation? Says Bloom. A nation is the same people living in the same place. By God, then, say Ned, laughing, if that's so I'm a nation for I'm living in the same place for the past 5 years. So of course everyone had the laugh at Bloom and say he, trying to muck out of it," See James Joyce, *Ulysses*, Vintage Books, 1986, pp. 272.

[4] Jean-Marie Guehenno, *The End of Nation State*, translated by Victoria Elliott, University of Minnesota Press, 2000, pp. 4.

[5] Ibid.

[6] Seton-Watson, Hugh, *Nations and States*, Westview Press, Inc., 1977, pp. 5.

each lives the image of their communion."[7] In short, a nation, according to Anderson is "an imaginary political community – and imagined as both inherently limited and sovereign."[8]

In defining state, Ernest Gellner argues that, at its core, is the specialization and concentration of order maintenance, "The state is that institution or set of institutions specifically concerned with the enforcement of order (whatever else they may also be concerned with)."[9] As a corollary of these two definitions the third notion, *nation-state* can be formed with denotation that implies "a community that specializes and concentrates on maintaining order."

While these definitions have render sufficient contextual framework for the objectives of this book, to find a general definitional consensus for nation and nation-state that satisfy a wide range of audiences and expertise is proven daunting task. This is partly due to the fact that each of us perceives the world as we get accustom with it. Kafka's fable "Before the Law" is, among other things, a reminder that each of us enters the world through a different door.[10] More importantly, however, the difficulties of reaching definitional agreement are mostly attributable to the nature of this type of investigations, which are ideological-charged, and hence commonly fail to separate the facts from pseudo-facts.[11] More importantly, and despite the fact that these notions have immensely influence one's mindset, reasonable theoretical grounds about them are noticeably absent. This emptiness starched to the point that Hugh Seton-Watson declared: "Thus I am driven to the conclusion that no 'scientific definition' of the nation can be devised; and yet the phenomenon has existed and exists."[12] To some extent, whether we consider the political function of

[7] Benedict Anderson, *Imagined Communities: Reflections on the Origin and Spread of Nationalism*, Verso, 1991, pp. 6.

[8] Ibid.

[9] Ernest Gellner, *Nations and Nationalism*, Cornel University Press, 1983, pp. 4.

[10] The summary of Before the Law plot goes as follow: "A man from the country seeks the law and wishes to gain entry to the law through a doorway. The doorkeeper tells the man that he cannot go through at the present time. The man asks if he can ever go through, and the doorkeeper says that is possible. The man waits by the door for years, bribing the doorkeeper with everything he has. The doorkeeper accepts the bribes, but tells the man that he accepts them 'so that you do not think you have failed to do anything.' The man waits at the door until he is about to die. Right before his death, he asks the doorkeeper why even though everyone seeks the law, no one else has come in all the years. The doorkeeper answers 'No one else could ever be admitted here, since this gate was made only for you. I am now going to shut it.'"

[11] According to Urban Dictionary, "A pseudofact is a piece of information that, despite being completely false, is far more interesting than the equivalent correct information. Because pseudofacts are more interesting, they are more likely to get repeated. This result in people who believe them because it's what their friends and family has always told them. This belief is often strong enough to ward off solid evidence of the contrary."

[12] Seton-Watson, Hugh, 1977, pp. 5. It is noteworthy that Seton Watson cites with some irony the would-be "scientific" definition of a nation by Joseph Stalin: "All that Stalin could say was that a nation must have four characteristics: a common language, a common territory, a common economic life and a common mental make-up. Stalin mentioned neither religion nor historical tradition" (Seton-Watson, pp.3–4).

a sovereign state, like defense, or the traditional function, like ensuring that the public has access to goods and services they consider essential, the concept of nation appears more and more like a straitjacket, poorly defined and inadequately adapted to the growing integration of the world.

Significant part of the difficulty in defining nation or nation-state is perhaps related to the popular tendency to defined Nationalism with capital "N" and then to validate "it" as a legitimate ideology. However, unlike most other ideologies that end with "ism," e.g., liberalism capitalism, communism, or even globalism, nationalism has never produced its own grand thinkers: no Hobbes, no Tocqueville, no Marx, and no Weber, etc.[13] This "vacuum" easily renders certain pretext for intellectuals to either consider the subject through condescending lenses, or simply avoid and dismissed it as irrelevant in modern time. For instance, consider Marxism. In what way one can explains the absence of questions related to nationalisms except by stating that these questions have proven uncomfortable anomalies for Marxist theoreticians to the extent that they have been elided, instead of confronted.[14]

Moreover, how else to explain Marx's frequent use of "national bourgeoisies" without a comprehensive attempt to justify theoretically the relevance of the adjective? To make the point clear, let's consider one of Marx and Engels grant works, *The Communist Manifesto*, in which they suggest: "Though not in substance, yet in form, the struggle of the proletariat with the bourgeoisie is at first a national struggle. The proletariat of each country must, of course, first of all settle matters with its own bourgeoisie."[15] Yet, they never addressed why this segmentation of the bourgeoisie is theoretically significant.[16] To simply claim, as Marxists usually do, that "the nationalism is a product of the bourgeoisie class and capitalism" is not only utterly insufficient but also disappointing.

The concept of nationalism, however, appears as the catalytic process, unifying various definitions of nation into a single collected mass, or as Gellner claims, "Nationalism holds that they [nations and states] were destined for each other; that either without the other is incomplete, and constitutes a tragedy."[17] To put it less dramatic, nationalism resembling Eugen Weber's account of peasants being turned into Frenchmen,[18] or Massimo D'Azeglio who after the Unification of Italy cried "We have made Italy, now we must make Italians." In Gellner's view, nationalism is

[13] Benedict Anderson, 1991, pp. 5.

[14] In related matter, Tom Nairn also observed: "The theory of nationalism represents Marxism's great historical failure," (See Tom Nairn, *Break-up of Britain*, Common Ground Publishing, 2003. pp. 317.).

[15] Karl Marx And Friedrich Engels, *The Communist Manifesto*, Wildside Press, 2008, pp. 22.

[16] In fairness to Marx and Engels, one can argue that such neglect is due to the fact that classical Marxism main emphasis is on history as the progressive augmentation of the forces of production or history as the progressive evolution of societies through class struggle, and hence the notion of nationalism dissolved in them.

[17] Ernest Gellner, 1983, pp. 6.

[18] Eugen Weber, 1 edition, *Peasants into Frenchmen: The Modernization of Rural France, 1870–1914*, Stanford University Press, 1976.

not a sentiment expressed by preexisting nations; rather it creates nations where they did not previously exist. Nationalism, observed Gellner, "is not the awakening of nations to self-consciousness: it invents nations where they do not exist."[19] The shortcoming of this perception, claims Anderson, is that "Gellner is so anxious to show that nationalism masquerades under false pretenses that he assimilates 'invention' to 'falsification' and 'falsity', rather than to 'imagining' and 'creation'."[20]

Nevertheless, the importance of Gellner to the present study is related to his description of nationalist principle that can be asserted in the "universalistic" spirit. According to Gellner, "There could be, and on occasion there have been, nationalist-in-the-abstract, unbiased in favor of any special nationality of their own, and generously preaching the doctrine for all alike: let all nations have their own political roofs, and let all of them also refrain from including non-nationals under it… As a doctrine it [universalistic spirit] can be effective to preserve cultural diversity or a pluralistic international system, and of the diminution of internal strains within states."[21] He further reinforces his argument by stating, "This argument [universality] is further and immeasurably strengthened by the fact that very many of the potential nations of this world live, or until recently have lived, not in compact territorial units but intermixed with each other in complex patterns."[22]

The Gellner's argument is particularly useful when applied at the global scale because it helps us to understand the place of the humans in the world, which is increasingly crucial to realization of the notion of universality and more importantly to the survival of the planet. Regardless of one's ideological beliefs, the prevailing consensus indicates that human actions have jeopardized many of the life-systems of the planet. To curtail, and eventually eliminate, these adverse affects we have no choice but to see our world in light of a universal perspective (also known among experts as a planetary perspective). To reach this vision, we must embrace the notion of *globalism*, which requires enhancement of communications between nations to foster understanding, support sharing of needed resources on the basis of equity and sustainability, and call for mutual aid in times of need, all of which point to the notion of globalism.[23] Moreover, one must navigates through the anthropocentric

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[19] Ernest Gellner, *Thought and Change*, University of Chicago, 1978, pp. 168. Emphasis added.

[20] Benedict Anderson, 1991, pp. 6.

[21] Ernest Gellner, 1983, pp. 2.

[22] Ibid.

[23] See Mark Ritchie, *Globalization versus Globalism*, International Forum on Globalization. This article is online: http://www.ifg.org. Nevertheless, generally speaking, Globalism is perceived to embrace at least two different and opposing meanings. "One meaning is the attitude or policy of placing the interests of the entire world above those of individual nations. Another is viewing the entire world as a proper sphere for one nation to project political influence. Political scientist Joseph Nye, cofounder of the international relations theory of neoliberalism, argues that globalism refers to any description and explanation of a world which is characterized by networks of connections that span multi-continental distances; while globalization refers to the increase or decline in the degree of globalism" (See Frederic P Miller, Agnes F Vandome, John McBrewster, editors, *Globalism*, VDM Publishing House Ltd., 2010.).

notion of creation that describes humanity as the central and most significant entity in the universe, and the nonanthropocentric vision that would leave other species the task of cleaning up human environmental destruction.

In fact, the notion of globalism can be expressed as a noble idea, the belief that we share one planet and its survival depends on mutual respect among its inhabitants and careful treatment of the Earth environment. In a sense, we would think, globalism is steered by people. Of course, the globe is crowded turf, and hence no one would expect all contributors to speak alike. And yet, they do have in common a belief in unlimited horizon. Wai Chee Dimock has perhaps said it best: "As a set of temporal and spatial coordinates, the nation is not only too brief, too narrow, but also too predictable in its behavior, its sovereignty uppermost, its borders defended with force if necessary. It is a prefabricated box. Any literature crammed into it is bound to appear more standardized than it is: smaller, tamer, duller, conforming rather than surprising. The randomness of literary action – its unexpected readership, unexpected web of allegiance – can be traced only when that box is momentarily suspended, only when the nation-state is recognized as a necessary but insufficient analytic domain, ceding its primacy upon scale enlargement."[24] To be sure, the idea of globalism might dispute the local as well as the national, personal experiences as well as collective ones, "but in any guise it is a horizontal phenomenon, dynamic because never fully visible. That is what constitutes it [globalism] as an idea"[25]

Globalism can also be defined as a doctrine. And as such, it incorporates the Global Commons, which are areas and resources that do not fall under the sovereignty of any state: the high seas, Antarctica, the Ozone layer, outer space. While, self-interest behavior provides the dynamics for the operation of global markets, in areas of Global Common, it can lead to a tragedy. As a result, realization of globalism can only comes about as a result of maturity of mankind that values morality, righteousness and dependability not as weakness but rather strength. In short, globalism is a realization of a utopian dream; it is sublime, elevating and disturbing, revealing and confusing. And yet, if we rise high enough we can see it is an inspired ideal that, in an uninspired world, may prove more inspiring than Kant's three *definitive articles*.

However, Gellner's argument of universality makes explicit a case for the kind of world that provides a suitable intellectual setting for the global mode to the extent that the notion of universalistic spirit can be seen as an interpretation, in which the world is perceived as homogenous structure, a *globalized system*, which pluralizes the world into the single economic framework.

[24] Wai Chee Dimock, *Through Other Continents: American Literature across Deep Time,* Princeton University Press, 2006, pp. 3.

[25] Marshall Brown, "Globalism or Globalization?" *Modern Language Quarterly*, June 2007, vol. 68, no-2, pp. 139.

In many respects, the globalized system is similar to an empire that controls no distinct territories but its realm covers the entire globe; an empire with no emperor whose capital cannot be located.[26] Once the borderless empire is established and the frontier disappears, whether in the case of a state, enterprise or corporation, procedures replace principles in a sense that top-to-bottom organizational management becomes a substitute for ideology. Consequently, the nature of power does change in a sense that power is no longer defined by mastery but rather through influence and network. Nowhere this observation is felt more than in the formulation and formation of policy decisions both at national or global levels. Decision-making process is fragmented, and traditional political debate, a debate about principles and ideological perspectives, a debate over how society is to be organized and function, faded away, or rather yield to interests and their army professionals.

The new empire has no constitution but instead constructed e body called "governance" that is concerned with the establishment and operation of the "rules of the game" that serve to define economic practices, assign roles, and guide interaction.[27] The new empire is free from any legacy, and is with no history to preserve and no ideology that may be contested. In this respect, the political inclination of the empire has no other purpose than the preservation of the rules set forth by its institutional setting – no account is required of a policy, only the assurance that a procedure has to be respected. To the great extent, respect for procedures is the only agreed operating standard of the new empire. Guehenno described the new empire when he observed, "We are entering into the age of open system, whether at the states or enterprises, and the criteria of success are diametrically different from those of institutional age and its closed systems. The value of an organization is no longer measured by the equilibrium that it attempts to establish between its different parts, or by the clarity of its frontiers, but in the number of openings, of points of articulation that it can organize with everything external to it."[28]

The necessary condition to sustain this empire has been already in place – no external threats, no barbarians at the gate. The global imperial age neither stands, nor tolerates conflict; it needs similarity and, in its absence, promotes conformity through standardization. This tendency is mostly due to the fact that in the prevailing system, in which the world is well "connected" with transparent regulations and disclosed rules, conflict should be perceived as a social anomaly. Guehenno underlined this point more eloquently when he observed that in the global system, "conflict supposed an incomprehensible incompatibility of perceptions: if there are both weak and powerful, how dare the weak engage in battle, when their defeat in

[26] As Guehenno stated, "Power is no longer settled in Washington, Moscow, London, Paris, etc. Rome will no longer be in Rome."

[27] Oran Young, *International Governance: protecting the environment in a stateless society*, Cornell University Press, 1994, pp. 15.

[28] Jean-Marie Guehenno, 2000, pp. 49.

inscribed in the social order?"[29] Perhaps, this observation can explain the reason why global governance is commonly perceived to be suited to prevent conflict rather than to resolve it.[30]

In this empire, behavior(s) of individual(s) or organization(s) often viewed, as if, it is originated as, and mainly remain, a *microeconomic* process. Supported by evolutionary psychologists and neo-liberal economic values, the pillars of such process are built on hypothetical evolutionary impulses, which suggest mankind share common drives like aggression, self-interest and utilitarianism.[31] At the individual level, instances like this are abundant. However, the one that comes to mind, especially in light of the crisis of past few years, is the fact that in the aftermath of a financial crisis that generated hundreds of billions in losses and millions of individuals lost the entire life-saving, their jobs and their houses, no high-profile participants, including bankers, related to the crisis has been prosecuted.[32] While, the main presumed reason for such neglect is the alleged complexities of pursuing legal cases in a time of panic, the underlying cause is the evolutionary impulses. At the organizational level, endorsement for these inclinations came from within. For instance, Charles Taylor, Director of the Pew Financial Reform Project, in his speech entitled "looking through Darwin's Glasses" puts forward the case for using evolution theory to

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[29] Ibid., pp. 70. However, as we know very well, conflicts do occur in the global system, and they require prevention through various means. As the report by Atlantic Council on Global Governance stated, "Prevention, for example, often can require direct political intervention or even the threat or use of military force as a last resort. Efforts to prevent conflict have often been slowed by reluctance and resistance to intervene directly, potentially overriding another country's sovereignty." (see Global Governance 2025; At a Critical Juncture, *Atlantic Council*, September 2010, pp. v).

[30] See Mathias Koenig-Archibugi, "Mapping Global Governance" and James N. Rosenau, "Governance in a New Global Order" in David Held and Anthony McGrew, edited, *Governing Globalization: Power, Authority and Global Governance*, Polity Press, 2002.

[31] The reader should note that these pillars are challenged by research in evolutionary biology, neuropsychology and child development, which questioned some of the conventional long held theories about human nature. Through various experiments, using the MRI brain-scanning machine, scientists have discovered that human beings, and perhaps some animals, are connected, what is called "soft wired," with what is known as "mirror neurons," which enable all humans to experience another's plight as if we are experiencing it ourselves. Selfhood goes together with empathic development (increase selfhood increase empathic development). In the psychological world, this is called empathy. In other words, empathy is as plausible as competition, self-interest, etc. The interested reader can read more on this topic in a fascinating book by Jeremy Rifkin (see Jeremy Rifkin, *The Empathic Civilization; The Race to Global Consciousness in a World in Crisis*, Jeremy P. Tarcher/Penguin, 2009).

[32] See Gretchen Morgenson and Louise Story, "In Financial Crisis, No Prosecutions of Top Figures," New York Times, April 14, 2011. It can be accessed at http://www.nytimes.com/2011/04/14/business/14prosecute.html?_r=1.

think of global financial institutional behavior.[33] Taylor stretches his explanation to the point that Darwin's natural selection is replaced by selection based on profitability. Evolution, he claimed, "breeds complexity, specialization and predator-prey relationship."[34] The main purpose of these hypothetical commonalities is to present the world as communities (individuals) that compete between and within themselves to accumulate, consume and fulfill their self-interest.[35] In some sense, globalization should be perceived as a culture, promoted by ideology, before it is defined as an ideology or a process.

Despite some resonant similarities between globalism and globalization, these notions convey different connotations. The most significant distinction among these differences is related to the nature as well as the origins of these notions. Globalism only can come about as a result of maturity of our civilization maturity and realization that humanity shared a common destiny. Consequently, globalism is formed by consensus and can be thought of as an international solidarity that strives on commonalities. In contrast, the prevailing globalization, a single global economic mechanism, is a forced feed process, which has been promoted rather than evolved. Consequences, such process incites popular discontents around the globe, as Robert Cox observed, "Globalization is generating a global resistance movement."[36] The movement, which begun in 1994 in Chiapas, Mexico, and mainly continues today.[37]

[33] Charles Taylor, "Macro-Prudential Regulation and the New Road to Financial Stability: Looking Through Darwin's Glasses," *Chicago Federal Reserve Bank/IMF conference: "Macro-prudential Regulatory Policies: The New Road to Financial Stability"; September 23–24, 2010*.

[34] Taylor description renders useful ammunition, particularly for "experts" journalists, to explain the recent economic policy. For instance, James mackintosh of Financial Times claimed, "From an evolutionary view, we might say government have abolished death in the lifecycle of banks" (see James Mackintosh, "Sex and Death in Financial Evolution," FT, March 24, 2011.)

[35] It should be noted that the issue of interpretation is important concern, and hence we offer a different view of these concepts so the reader is expose to diversified views on these subjects. For instance, Steger draws attention to the differences between empirical observations and interpretive framings and suggesting the different between globalization and globalism can be explained as: "globalism constitutes a coherent discursive regime that shapes the social understandings of authority, but it is not a monolithic ideology. A complex phenomenon, it comes in many variations on the main theme of market liberalization… [Its] preferred method is to employ its dominant codes and hegemonic meanings as battering rams to crush the remaining obstacles in the path of global capital" (p. 13). Thus for Steger, globalism refers to a discursive matrix that has certain ideological effects. See Manfred, B. Steger, *Globalism : the new market ideology*. Lanham, Md., Rowman and Littlefield Publishers, 2002.

[36] Robert Cox and Michael G. Schechter, 1 edition, *The Political Economy of a Plural World: Critical reflections on Power, Morals and Civilization*, Routledge, 2002, pp. 136.

[37] For a comprehensive analysis of these unrests see Anup, Shah, *Public Protests Around The World*, Global Issues, 2003. For an analysis of Chiapas unrest see Richard Stahler-Sholk, "Globalization and Social Movement Resistance: The Zapatista Rebellion in Chiapas, Mexico," *New Political Science*, Vol 23, Issue 4, December 2001, pages 493–516.

In our view, significant portion of the globalization constitutes neither behavioral wisdom, nor cultural development, but instead finds its origin in the changing patterns of "… transborder operations of firms undertaken to organize their development, production, sourcing, marketing and financing activity."[38] The essence of globalization is the integration of production across national boundaries, or as Richard Lipsey has observed, a globalized economy is one that "…increasingly integrates both the financial and the production sectors of economies of many individual countries."[39] Thomas Hatzichronoglou follows the similar sentiment and claims, "The economy's entry into its globalisation phase has radically altered the nature of competition. Now, numerous new actors from every market in the world are simultaneously in competition on every market."[40]

Heightened competition at home and abroad accentuated the interdependence that obviously strives on diversities rather than commonalities. In effect, the International Monetary Fund defines globalization as the "growing economic interdependence of countries worldwide through increasing volume and variety of cross-border transactions in goods and services, free international capital flows, and more rapid and widespread diffusion of technology."[41] International organizations,[42] particularly Bretton Woods institutions, through highly value-laden policies, e.g., liberalization and deregulation, systematically reinforce this trend. [43] This observation may seem to contradict the popular view that express by popular commentator like Thomas Friedman when he claims "the most basic truth about globalization is this: No one is in charge," or upper echelon managements of financial institutions, like Rober Hormats, the vice chairman of Goldman Sachs International when he claimed, "The great beauty of globalization is that no one is in control. The great beauty of globalization is that it is not controlled by any individual, any government, any institution." While these statements have some merit in a strict sense, which denied the existence of orchestrated entity created by tacit collusion among "imperial evil forces," it is quite sensible to think that the prevailing global economic system must be sustained and managed to secure its future.

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[38] OECD, Globalization of Industry: Overview and Sector Report, 1996, p. 15.

[39] Richard G. Lipsey "Global change and economic policy," in Nico Stehr and Richard V. Ericson, eds, *The Culture and Power of Knowledge*, Walter DeGruyter, 1992, pp. 285.

[40] T. Hatzichronoglou, "Globalisation and Competitiveness: Relevant Indicators," *OECD Science, Technology and Industry Working Papers*, 1996, pp. 3.

[41] IMF, "World Economic Outlook," May, 1997

[42] The reader should note that in this book we used various adjectives such as Bretton Woods, coordinating agencies, lending agencies, etc., to described international organizations. The main reason for doing so is related to the context i.e., global governance in which we analysis the conduct of these agencies. We feel that such variety in description is a necessary condition to explain these agencies role in the context of global economic system.

[43] Value-laden policies implies that they are implemented not by their merit but rather by policy-makers ideology. For instance, a survey of the literature on capital account liberalization by Eichengreen concludes that there is no empirical substantiation of the conventional theoretical tenets about the growth benefits of capital account liberalization. See Barry J. Eichengreen, "Capital Account Liberalization: What Do Cross-Country Studies Tell Us?" *World Bank Economic Review*, Vol. 15 (October), pp. 341–65.

In this respect, and unlike globalism, globalization is ahistorical process in which promoted and sustained, more or less, by various international organizations, e.g., IMF, the World Bank, WTO, etc., and manage by the world-governance system, which is a multilateral system.[44] This process is also more or less endorsed by the industrialized states (OECD nations) under the leadership of the USA. It is not surprising that for the past 3 decades, all US presidents have been heralding the benefits of merging the American economy with the rest of the globe. George Bush Sr., Bill Clinton, George W. Bush, and Barack Obama have all steadfastly supported the emerging one world economy. These presidents have each used different terms to describe this process such as "globalization," "an integrated world," "the global economy" and even "a New World Order," but they have all seem to imply the same thing; a single world economy so that the single institution setting project its' influence. All of these presidents have sought to integrate the USA even more deeply into the developing one world economic system. For instance, only 6 months into

[44] In the context global governance, article 151 of Forum for a new World Governance underlined why the global governance is need, "the executive, legislative, and judicial structures inherited from the past do not provide an adequate response to the complexity of contemporary society" See (http://www.world-governance.org/spip.php?article151.) Moreover, the article claimed to the world-governance system, "we must go beyond the conceptual and ideological foundations of the current system. One of the necessary innovations is to introduce a regional level of governance, between national and world institutions. We need to prevent, for example, the construction of Europe from being undermined by sterile arguments among states. Europe represents a historic effort to build a supranational entity on the foundations of economic convergence and community law. New negotiations and decision-making processes must be anchored at a regional level, something that the future – and inevitable – reform of the UN Security Council needs to take into account. The Security Council ought to be a world committee in which all the regions of the planet are represented. Its chair would be held on a rotation basis by a country of one of the regions, which would also represent it in international negotiations." See (http://www.world-governance.org/spip.php?article151.). The article 152, identified five principles on which to build governance. They are as follows: (1) Legitimacy in the exercise of power. Exercise of power must be linked to a clearly expressed mandate from the people as to how they are to be governed. Persons in positions of authority must be deemed worthy of the confidence placed in them. Limits on private freedom must also be reduced to a minimum and clearly perceived as necessary for the commons. Organization of society must be based on ethical principles that are recognized and respected; (2) Conformity with the democratic ideal and with the principles of citizenship. All individuals must feel that they are part of a shared destiny, which excludes, for example, tyranny by the majority. Rights, power, and responsibility must be evenly balanced. No one can exercise power without being subject to checks and balances; (3) Competence and effectiveness. The way that public and private institutions are set up, their organizational structures, and the people working within them must all be reviewed to ensure that they remain pertinent, and that they have the skills and the capacity required to assume responsibility for responding to the needs of society in all of its diversity; (4) Cooperation and partnership. It is essential that everyone work together for the commons and that governance organize relationships and cooperation among the various types of player, whether public or private, the various levels of governance, and the various administrations in accordance with procedures established by common agreement; and finally (5) Linking the local and the global, and the different levels of governance. Societies must be able to organize themselves in such a way that the autonomy of the smallest communities is compatible with social cohesion at all levels, up to and including the global level. See http://www.world-governance.org/spip.php?article152.

Clinton Administration economic acronyms such as G7, NAFTA, APEC, and GATT become major part of his policy declarations. As Clinton saw it, the USA was "like a big corporation competing in the global marketplace."[45] Barack Obama also showed very clearly how he feels about this emerging notion of one world economy when he made the following statement during his speech in Mumbai, India, 2010: "This will keep America on its toes. America is going to have to compete. There is going to be a tug-of-war within the US between those who see globalization as a threat and those who accept we live in a open integrated world, which has challenges and opportunities."[46]

In retrospect, the task we chose for the present study is narrow in its vision and limited in its ambition. However, we have tried simply to present various observations and use common sense to correct errors of fact, conception, and interpretation, which would assist us to avoid inconsistency and redundancy in the following chapters. There are no assumptions in our arguments, except in those cases that making assumption is an intrinsic part of conceptual argument and framework. Our objective is to show how the new global order contributes to the new economic arrangements and organizations.

Our view is based on three distinct pillars (1) financial institutions, through rapid technological advancements, not only are strengthening their operations and diversify their services but also expand their domain of activities, and hence provide a necessary condition to *sustain* global capital flows that are vital to existence of the global economic system; (2) creation of global institutional setting, e.g., global governance, in addition to coordinating agencies e.g., the World Bank, IMF, UN, etc., renders the necessary institutional infrastructure for *managing* adverse affects of the global economic system; and (3) the prevailing global economic interdependence has caused major change in the structure of global production, which has led to decline in the authority of nation-states over their national economy – in terms of deciding; *what* should be produced in the economy; *how* within the existing factors of production (land, labor, capital, and technology) should be produced; and *for whom* the output should be produced.

[45] Economist Paul Krugman, in a 1994 *Foreign Affairs* essay, decried this quotation. He further alluded that the world's leading nations are not, to any important degree, in economic competition with each other. Nor can their major economic woes be attributed to "losing" on world markets. This is particularly true in the case of the USA. He criticized "dangerous obsession" with "national competitiveness" and pointed out that the tendency to think that "the United States and Japan are competitors in the same sense that Coca-Cola compete with Pepsi," is "flatly, completely and demonstrably wrong." See Paul Krugman, "Competitiveness: A Dangerous Obsession," *Foreign Affairs*, March/April, 1994.

[46] http://www.whitehouse.gov/the-press-office/2010/11/07/remarks-president-and-first-lady-town-hall-with-students-mumbai-india.

Technological Advancements and Financial Institutions

In 1945, a paper by Caroline Isard and Walter Isard points out that the most pervasive changes in the economy came from innovations in transport and communication.[47] More than 30 years later, in 1987, Office of Technology Assessment conducted a pioneer report about the impact of technological change in the US economy. In the introduction, the report made stunning observation, "During the next 2 decades, new technologies, rapid increases in foreign trade, and the tastes and values of a new generation of Americans are likely to reshape virtually every product, every service, and every job in the U.S. These forces will shake the foundations of the most secure American businesses."[48] Furthermore, the report painted a dismal picture of the future by stating, "Change can lead to wrenching dislocation and pain for workers with obsolete skills, for management unable to recognize opportunity, and for communities where traditional businesses have failed." It has now been 23 years since that report, and by all accounts, evidences seem to strengthen the report's judgments not only in the U. S but also around the global. Indeed, technological changes and innovations are commonly perceived as one of the major factors driving the global economy.

Our position on technology and subsequently its impact on globalization do not quite match with the conventional stand, which subscribes to techno-determinism. For instance, if you say that the Internet has changed business or politics, you are saying that technology itself has determining effect, and you are a techno-determinist. However, we view technology in a different light and described it as a mere tool, which can be used as an oar to propel a boat or to enable a space shuttle. In this respect, our concern is not whether the Internet taken by internal forces creates certain effects on us, but weather technology has determinative effects. We are convinced that the determinative power of technology is not intrinsic. It comes from its uses by various entities like institutions, individuals, etc., which eventually explains the current state of global economic system in light of *power* exercised by the global financial institutions.[49]

To start, we must apply great care in using technology as a noun and then make general inferences as if the noun is confined to its absolute connotation. In our view, it is not. For one thing, we subscribed to Harvey Brooks' definition of technology, in which technology "is the use of scientific knowledge to specify ways of doing

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[47] Caroline Isard and Walter Isard, "Economic Implication of Aircraft," Quarterly Journal of Economics, vol. 59, 1945, pp. 145–169.

[48] *Technology and the American Economic Transition: Choices for Future*, Office of Technology Assessment, 1988, pp. 3.

[49] However, this does not imply that we outright reject the role of technology in global economic system, but rather places the emphasis elsewhere.

things in a reproducible manner."[50] Moreover, we must clarify the type of technology under consideration. For instance, Ernst Friedrich "Fritz" Schumacher in his book "Small is beautiful" introduced the term "intermediate technology" (or appropriate technology), and defines it as tools that are much cheaper than technologies developed in developed world and can be used in the developing countries more effectively in a decentralized way and without much training form outside.[51] Moreover, it is a gross mistake to infer impacts of technological innovations and developments in a uniform matter. Technological changes come in varying degrees and so do their affects on environments in which they occur. For purpose of clarity we underlined four types of improvements: incremental innovations; radical innovations[52]; changes in technology systems; and technological revolutions. Respectively, the common sense indicates to consider how different technological changes would have led to different outcomes.[53] Accordingly, in the following, we tried to be specific in the various examples given, so the reader related them to the real world.

We argue in this book that technological developments per se should not be considered as vehicles of change because they are just means or tools used to achieve a certain goal and/or improve or change existing processes.[54] Technological advancements

[50] Harvey Brooks, "Technology and Ecological Crisis," lecture given at Amherst, May 9, 1971, p. 13, from unpublished text, italic added. For better understanding of professor Brooks' see *Technology, Processes of Assessment and Choice*, Report of the National Academy of Science, published by the Committee of Science and Astronauticiem, U.S., House of Representatives, July 1969, and Science Growth and Society, OECD, (Paris, 1971).

[51] See E. F. Schumacher, *Small Is Beautiful: Economics as if People Mattered*, HarperCollins Publishers, 2010. For dentition of the term see pp. 190–92.

[52] Henderson and Clark (1990) described incremental innovation as relatively minor changes to existing designs that exploit the potential of the established design, and often reinforce the dominance of established firms, as opposed to radical innovation, such as the introduction of a totally new type of machinery.

[53] Industrial revolutions were possible only because of *technological revolution* such as the steam engine, steel, and electricity (see Andrew Atkeson and Patrick J. Kehoe, "Modeling the transition to a new economy: lessons from two technological revolutions," *American Economic Review*, vol. 97, no. 1, March 2007, pp. 64–88).

[54] We certainly can add to this list the social aspect of technological development. Indeed, We also must pay great attention to social consequences of technological development in the prevailing world. Today, there are those who invent/own knowledge and define the procedure, and those who carry them out, which increasingly implies those who supervise their execution by machine. The consequence of this division is profound, as Guehenno observed, "The individuals in the contemporary enterprises are far too atomized to cultivate bond of solidarity, far too rootless to find in the notion of social class an answer to their need to belong. Integrated into the enterprise whose regulations they master, but vulnerable nevertheless, solidarity, remote from any tangible product, they owe it to themselves to be 'conformist': but this conformity does not afford them an identity." (See Jean-Marie Guehenno, 2000, pp. 44).

do not occur in vacuum.[55] Indeed, throughout the history, they spark responses from economic, political and social environments. For instance, the past technological development such as telecommunication, automatic control machinery, and supersonic transportation each has been directly affected by a complex set of interactions among technological, economical, political, social, and legal consideration.[56] More to the point, our argument is based on the notion that "necessity is the mother of invention." This implies that solutions to problems (the invention bit) are born out of the propensity to meet prevailing challenges (opportunities), or the exiting need (the necessity), to achieve certain objectives. Once the need is identified, the tools will be adapted according to the characteristics of the people and institutions involved, and their economic objectives.[57] Financial institutions usage of technology is not only to meet the prevailing global economic conditions, but also assist them to attain their main objectives, profit maximization, is ample illustration this process.

Capital markets (markets for securities – debt or equity) around the world have been linked for some time now. The October 1987 crash, which began in Hong Kong, and then spread to West through the international time zones to Europe and then to the USA, renders ample evidence that capital markets incline to move in parallel in response to economic and financial events, and react sharply to the stress in other markets. Moreover, several developments change the nature of international trade, and hence the globalized economy. Among many we only name the few here: (1) rapid economic interdependence underlined the growing complexity of cross-border transactions; (2) technological advancements in transportation[58] such as the development of what the trade calls LASH (lighter-aboard-ship) systems and RORO (roll- on, roll-off) vessel, significantly improved the pace of international trade; (3) advances in telecommunications and information processing lowered transaction cost and risk of managing trade at a distance; (4) the emergence of the Internet has reduced information asymmetry, and hence giving individual investors unprecedented access to the global marketplace. Inevitably, these evolutions have led to the

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[55] In contrast, there are those who believed that "Industrial history shows that the development of new technology can have a major impact on any industry and has often done so. This is most especially the case when technology affects the very core of the business – in the case of banking: information, processing and delivery. In this respect, banking is no different from other industries. It is largely technology, and what follows from it, that will transform the banking and financial services industries." See Malcolm Edey, editor, *The Future of Financial System*, Proceedings of a Conference held at the H.C. Coombs Centre for Financial Studies, Kirribilli on 8/9 July 1996, pp. 141.

[56] For instance see Mel, Horwitch, *Clipped Wings: A Study of the Supersonic Transport*, MIT press, 1982; Graham. W. Astley and Charles Fombrun, "technological innovation and industrial structure: The case of telecommunication." In Robert lamb (ed.), Advances in Strategic Management, JAI Press, 1983; and David Nobel, *Forced of Production: A social History of Automation*, Knopf, 1984.

[57] The process by which technological benefits are realized is essential in understanding and assessing technological developments since only through such process tailoring occurs to achieve the specific objective.

[58] Transportation is often referred as an *enabling factor* that is not necessarily the cause of international trade, but a mean over which globalization could not have occurred without.

need for more and unrestricted capital, which include widening financial services and instruments as well as restructuring, especially in banking industry.[59] These changes are mostly due to the fact that like a capitalistic system, the global economic system is built on circular flow of capital to the extent that without it, there is no globalization.[60]

As financial institutions identified the prevailed conditions, they expanded their activities across borders, improved their payment systems and raise their ability to provide cash management or working capital services.[61] They also abandoned traditional financial instruments and creating the new financial instruments, e.g., derivatives, which no one really understands and no one, with few exceptions such as Guy Hands, is ready to admit the void.[62] While financial innovations are blamed for

[59] According to Loretta J. Mester of Federal Reserve Bank of Philadelphia, the banking industry has been undergoing significant restructuring since the mid 1980s. For instance, the number of commercial banks has fallen while average bank asset size has increased. This has led to concentrated financial service industry, in which a handful of very large institutions can exert monopoly power (see Loretta J. Mester, "Economies of Scale and Scope," in Anthony Saunders, *Financial Institutions Management: A Modern Perspective*, Irwin, 1994, p. 230). Allen N. Berger followed Mester observation and found the similar conclusion from 1984 to 2002 (see Allen N. Berger, "The Economic Effects of Technological Progress: Evidence from the Banking Industry," *Journal of Money, Credit and Banking*, vol. 35, no. 2 (Apr., 2003), pp. 141–176).

[60] It should be noted that there is a difference, which often neglected, between a free market economy and capitalism. A free market economy is a system that mainly concerned with exchange of goods and services while capitalism leans more on wealth creation for themselves. A free market economy operates by "demand and supply" analogy and at the optimal level is leading to free competition without interference. However, in capitalism, capital owners incline to interfere, e.g., the terms of trade, to obtain larger share of wealth. In this respect, exchanges in various markets are a key component of capitalism although they do not fully define what capitalism is. Read more: Difference Between Capitalism and Free market | Difference Between | Capitalism *versus* Free market http://www. differencebetween.net/business/difference-between-capitalism-and-free-market/#ixzz1DNvaMtip.

[61] Among major services provided are (1) wholesale lockbox – a centralized collection services for corporate payments to reduce the delay in check clearing or the float (the time between when a check is received and when the funds are credited to the account); (2) electronic funds transfer – includes overnight payments via Clearing House Interbank Payment System (CHIP) or Fedwire transfer network, automated payment of payrolls or dividends via automated clearing house (ACHs), and automated transmission of payment messages by Society for Worldwide Inter-bank Financial Telecommunication (SWIFT) (an international electronic message service owned and operated by US and European banks that instructs bank to make particular payment); (3) Electronic initiation of letter of credit – allows customers in a network to access bank computers to initiate letters of credit; and (4) treasury management software – allows efficient management of multiple currency portfolios for trading and investment purposes (for more information see Anthony Saunders, 1994, pp. 217).

[62] Traditional financial instruments are like repurchase agreements (receivables), bonds, and capital stock. Derivative instruments constitute formal agreements to transfer risk from one party to another without transferring the underlying basic instrument. The reader should also noted that financial derivative is not the only hedging products that currently exist, and in fact it only represents a fraction of the massive innovative financial instruments that are making their way into the financial scene. A useful listing of additional innovative financial products can be found in John E. Stewart, "The Challenges of Hedge Accounting," *Journal of Accountancy*, November 1989.

recent financial crisis and seem to be synonymous with credit-default swaps and collateralization debt obligations and derivative securities, the former IMF chief economist Rajan remind us that these "innovations also gave us the money-market account, the credit card, interest-rate swaps, indexed fund and exchange-traded funds" [63] all of which have been proved very profitable for financial institutions. For instance, in 2007, only the derivative markets valued at $531 trillion.[64] Moreover, technology has allowed the creation of a globally integrated market for distinct, unbundled financial attributes. [65]

The high-speed technology such as algorithmic trading (or also known as automated trading) is used by many large hedge funds, pension funds, and mutual funds allowing them to divide many large scale trades into small chunks and therefore minimize risk and exposure in the market place. Artificial intelligence enables financial institutions to replaced man with a machine, which assists these institutions to observed billions rather than hundred market transactions.[66] Ray Kurzweil,

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[63] Raghuram G. Raja, *Fault Lines: How Hidden Fractures Still Threaten the World Economy*, Princeton University Press, 2010, pp.159.

[64] *New York Times*, October 8, 2008.

[65] Any financial instrument can be thought of as a bundle of financial attributes, such as amount, term, currency, repricing interval, base rate, credit risk, tax benefits, etc. The new technologies, caps, floors, options, futures, and so forth are used to unbundle and repackage these attributes. Traditionally, a financial instrument was priced by comparing it to other instruments of the same name and the same structure trading in the same market. Today, it is common to price an instrument by comparing it to pieces or packages of other types of instruments in many different markets, which in combination produce the same financial result, that is, the same bundle of financial attributes. For example, a US dollar floating-rate loans from a US bank is not simply compared to other floating-rate loans offered by other US banks. It is also compared to a fixed-rate Eurodollar bond issue coupled with an interest rate swap and to a floating-rate sterling loans from a UK bank coupled with a currency swap. All produce the same bundle of attributes: funding in a given currency for a given term that floats off a given base rate at the given repricing interval (see Charles S. Sanford, Jr and George J. Vojta, "Deregulation, Technology, and the Safety and Soundness of the Financial System" in Martin Feldstein, *The United States in the World Economy* (National Bureau of Economic Research Conference Report), University of Chicago, 1989, pp. 268).

[66] Ironically, as Goldin and Vogel point out, "Technological change via the acceleration of computer processing has greatly contributed to system fragility because microprocessors facilitate logistical chains, increase connectivity and facilitate the innovation of complex financial instruments, the underlying mathematical theories of which can be flawed, hard to understand and even more difficult to regulate (see Colander, D., Goldberg, M., Haas, A., Juselius, K., Kirman, A., Lux, T. and Sloth, B., 'The Financial Crisis and the Systemic Failure of the Economics Profession', *Critical Review*, 2009, 21 (2–3), pp. 249–267). Daníelsson argues that while statistical risk models are applicable to small frequent events, such as internal risk management, these models do not and cannot account for systemically important events (see J. Daníelsson, 'Blame the Models', *Journal of Financial Stability*, 2008, 4, pp. 321–328). In retrospect, it is not surprising that both the traders and regulators had a poor understanding of the systemic risks of new financial instruments. This is because 'when interconnections are dense, it may be difficult to trace the impact of any change even after the fact, let alone predict it ahead of time, making the system complex and hard to control' (see R. Jervis, *System Effects: Complexity in Political and Social Life*, New Jersey: Princeton University Press. 1997, p. 17)." (see Ian Goldin and Tiffany Vogel, "Global Governance and Systemic Risk in the 21st Century: Lessons from the Financial Crisis," Global Policy, January 2010, vol. 1, iiuse 1, pp. 11.). The cross-references were added.

an inventor and new hedge fund manager, is describing the future of stock-picking, and it isn't human. "Artificial intelligence is becoming so deeply integrated into our economic ecostructure that some day computers will exceed human intelligence,"[67] Kurzweil tells a room of investors who oversee enormous pools of capital. "Machines can observe billions of market transactions to see patterns we could never see."[68] Louis Morgan, managing director of HG Trading, a three-person hedge fund in Wisconsin, also observes, "5 years ago it would have taken $500,000 and 12 people to do what today takes a few computers and co-worker. I'm executing 1,500–2,000 trades a day and monitoring 1,500 pairs of stocks. My software can automatically execute a trade within 20 ms – five times faster than it would take for my finger to hit the buy button."[69]

These developments confirmed by many observers of the globalized economic system. For instance, Reinicke observed, "technological innovation itself is a rich source of new products and services, especially the financial services that create international business opportunities. Computer-driven financial innovation such as 24-h trading, program trading, online trading, and electronic settlement have provided the hardware and software that now make it possible to move huge sums of money around the globe in interval often measured in seconds."[70] In short, adaptation of technology by financial institutions "helped to globalize financial market and drove up trading volumes."[71]

The adapted technological tools, as we argued above, should also reflect the characteristics and the economic objectives of financial institutions. To confirm this, one needs only to listen to voices of the insider. A well-known quant (quantitative analyst) Paul Wilmott[72] informed New York Times readers "Hedge funds won't necessarily care whether the increased volatility causes stocks to rise or fall, as long as

67 Charles Duhigg, "Artificial intelligence applied heavily to picking stocks" – Business – *The New York Times*, November 23, 2006.

68 Ibid.

69 Ibid.

70 Wolfgang H. Reinicke, *Global Public Policy: Governing Without Government?* Brookings Institution Press, 1998, pp. 16.

71 "Moving markets Shifts in trading patterns are making technology ever more important," *The Economist*, Feb 2, 2006.

72 According to Newsweek magazine, "Paul Wilmott is a 49-year-old Oxford-trained mathematician and arguably the most influential quant today, the brightest star in their insular, nerdy universe. The Financial Times calls him a 'cult derivatives lecturer.' Nassim Taleb, the mathematician and author of the bestseller The Black Swan, calls him the smartest quant in the world. 'He's the only one who truly understands what's going on … the only quant who uses his own head and has any sense of ethics,' says Taleb. Wilmott stands atop a veritable quant empire. His wonk-made-simple textbooks sell for hundreds of dollars. A subscription to his bimonthly magazine, Wilmott, costs $695 a year. His Web site, Wilmott.com, is the nerve center of the quant community, with 65,000 registered users and a chat forum that buzzes over such topics as geodesic stochastic manifolds and swaption vol arbitrage." See http://www.newsweek.com/2009/05/28/revenge-of-the-nerd.html.

they can get in and out quickly with a profit."[73] Indeed, these institutions made immense profits. A report released in August 2009 by the TABB Group, a financial services industry research firm, estimated that the 300 securities firms and hedge funds that specialize in this type of trading took in roughly $21 billion in profits in 2008, the year that financial meltdown hits the global market.[74] All things considered, one can conclude that specific technological tools and innovation are adopted because they greatly contributed to the profit maximization of financial institutions.

In addition, significant portion of adapted technological advancements have, directly or indirectly, contribute to sustainability of the global system in a sense that they help global coordination agencies like IMF and the World Bank to monitor the economic system and managed possible crisis as they may unfold as well as facilitate collaborations among these agencies. For instance, information technologies, particularly in data architecture domains, have greatly aided the gathering and distribution of various sorts of data e.g., financial, political and economic data. For instance, a successful implementation of *the macro-prudential approach*,[75] which was endorsed at the G20 Summit in London, "requires a huge amount of up-to-date – if not real time – data from a variety of sources. This data will need to be analyzed for indicators of treats to the system and shred in a digestible form with senior international policy makers."[76] Indeed, the Declaration on Strengthening the Financial System, published with the London Summit Communique, calls for the launch by the IMF and FSB of an "Early Warning Exercise" at their spring 2009 meetings.[77]

Moreover, investment in well-suited technological tools has potential, "…for increasing both the FIs [financial institutions] net interest margin, or the difference between interest income and interest expense, and other income."[78] For instance, as a result of technological adaptation, *interest income* can increase if the financial institution sells a broader array of financial services, which may include cross-selling of financial products by computer matching customers and telemarketing of financial services products and bank products.[79]

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[73] Opalesque (4 August 2009). "Opalesque Exclusive: High frequency trading under the microscope."

[74] Ibid.

[75] In its mots general form, "macro-prudential" approach recognizes the importance of general-equilibrium effects, and seeks to safeguard the financial system as a whole. By contrast, a micro-prudential approach is one in which regulation is partial-equilibrium in its conception, and aimed at preventing the costly failure of individual financial institutions.

[76] Angus Hislop and Peter Gruetter, "Using Technology to Accelerate G20 Plans for Strengthening Global Financial Supervision," *Cisco Internet Business Solutions Group (IBSG) white paper,* 2009, pp. 2.

[77] See the London Annex at: http://www.pittsburghsummit.gov/resources/125091.htm.

[78] Anthony Saunders, 1994, pp. 215.

[79] For examples see Ibid, pp. 215–217.

Technological tools also facilitate information sharing among financial institutions. In terms closer information sharing, G20 Group acknowledged, "Bilateral Memoranda of Understanding are an important means for information sharing between banking supervisors. We ask the Basel Committee on Banking Supervision (BCBS) to consider up-dating its 2001 template for information exchange ("Essential Elements of a Statement of Cooperation between Banking Supervisors") in the light of current best practices and to consider further improvements that would enhance bilateral information exchange and supervisory collaboration world-wide."[80] G20 Working Group also recognizes that "for effective early warning, data collection must be strengthened," and recommends that the IMF and FSB provide proposals to this effect before the next meeting of G20 finance ministers in September.[81] Finally, to strengthen collaboration effort, "A range of technologies is being used by international companies to enhance collaboration. These extend from closed social networks and discussion forums to voice, video, and data-sharing technologies. One particular new technology developed to address the challenge of enhancing collaboration is telepresence – a high-definition-video, sensitive-audio system that matches the experience of physical, face-to-face meetings. There is a range of configurations that meet the needs of small to very large groups across multiple locations. While it is possible to envision virtual meetings of whole boards – as is already being practiced in the private sector – the more likely early use is as a substitute for many of the smaller committee and working group meetings of senior officials of supervisory agencies."[82]

In retrospect, technological advancements per se should not be considered as an agent of change but rather the emphasis should be on institutions that utilize these tools to achieve their economic objectives. This takes us to the second part of our argument, in which we suggest that the current state of globalized economic system is mostly due to the *power* exercised by financial institutions. However, before we go further, it is imperative to clarify one important issue, that is, to define the notion of power.

Power and Financial Institutions

The Notion of Power

To understand an idea, a mere definition is certainly misleading. Instead one must take into consideration the domain in which the notion is investigated, but more importantly contrasting perspectives under which the idea is labeled and explained.

80 G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets (WG2), Final Report, 27 March 2009, pp. 4.

81 Ibid. pp. 27/8.

82 Angus Hislop and Peter Gruetter, 2009, pp. 5.

The main reason for such a care is the fact that the meanings of a term should not be taken as absolute since they vary depending on their user's approach and perception to the subject. This is necessarily so in any field where theories are contradictory, e.g., social science disciplines. The contradiction of theories creates differences in the meaning of terms across theories. In this respect, the notion of power is not an exception. With this in mind, we start to examine the idea of power by tracing it back to the Social Science disciplines, and in particular economics, which is the most relevant field to the context of the present study.

In 1972, Abba Lerner claimed, "Those who benefit from the activity gain the approval of those who object by giving them something to get them to agree. What I want particularly to stress is that the solution is essentially the transformation of the conflict from a political problem to an economic transaction. *An economic transaction is a solved political problem*. Economics has gained the title of queen of the social sciences by choosing solved political problems as its domain."[83] Indeed, with some exceptions, the standard approach to the notion of power among conventional economists was best summed up by Paul Samuelson "Remember that in a perfectly competitive market, it really does not matter who hires whom; so have labor hire capital."[84] In this respect, it is not surprising that "the term [power] does appear among the 1,300 or so index entries of the leading graduate microeconomics text."[85] In this respect, the first point we would like to underlined is the fact that by not considering the notion of power relevant to economic explanation, economists failed to capture it's essence, that is, power as an effective means to gain economic advantage in private exchange. As such, we argue in this book, the notion of power bears significant weight in constructing as well as shaping the future of global economic system.

It is a common knowledge that the notion of power has close link to politically charged words such as "coercion" and "freedom," "democracy," which generally evokes controversy and debates among philosophers and political theorists.[86]

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[83] Abba P. Lerner, "The Economics and Politics of Consumer Sovereignty," *The American Economic Review*, Vol. 62, No. 1/2 (Mar. 1, 1972), pp. 259. Emphasis is added.

[84] Paul Samuelson, Samuelson, P. 1957. "Wages and interest: a modern dissection of Marxian economics," *American Economic Review* vol. 47, no. 6, Dec., 1957, pp. 894. Samuelson in the footnote elaborates further, "The argument holds even if capitalists do all the hiring, provided only that workers go where they get highest w and competing capitalists do what gives highest profits." (See Ibid). In respond, John Kenneth Galbraith chided economists for not examined more thoroughly the relationship between the factors of production, where power is associated with some factors and not with others. For instance, he asked, "why did ownership of land once convey plenary power over the dominant form of productive enterprise and, therewith, in the community at large?" (See John Kenneth Galbraith, The New Industrial State, 4th edition, Houghton, Mifflin Company, 1985, pp. 49).

[85] Samuel Bowles, Samuel and Gintis Herbert, "power." *The New Palgrave Dictionary of Economics*. Second Edition. Eds. Steven N. Durlauf and Lawrence E. Blume. Palgrave Macmillan, 2008.

[86] For instance, we refer the reader to: P. Bachrach, and M. Baratz, "The two faces of power," *American Political Science Review*, vol. 56, 1962, pp. 947–52; B. Barry, ed., *Power and Political Theory: Some European Perspectives*, John Wiley, 1976; Steven, Lukes, 2nd edition *Power: A Radical View*, Palgrave Macmillan, 200; and Steven Lukes, *Power* (Readings in Social and Political Theory, No. 4), NYU Press, 1986. These are among many books on this topic.

Nonetheless, even among political theorists, no consensus has emerged so far in term of *general theory of power*. However, on the epistemic front, several views were expressed, in which we briefly underlined as the point of reference. Some, most notably Hans Morgenthau among them, views power in the content and the manner of its use, both of which are determined by the political and cultural environment. Power, claimed Morgenthau, "may comprise anything that establishes and maintains the power of man over man…from physical violence to the most subtle psychological ties by which one mind controls another. Power covers the domination of man by man."[87] Morgenthau's description of power, therefore, can be seen as *relational*, that is, power in relation to others (man, states, etc.).

In contrast, Kenneth Waltz views power in the international system and suggest that it can be understood as the *capacity* of a state, most notably military capability, to affect the behavior of other states (while resisting unwelcome influence from those states).[88] Waltz's description is mostly due to the traditional thinking in international relations, with deliberate behavior, and inevitably with states. States have monopolized power because they have military capability (resources). As McCormick observed, "Powerful states have integrated militaries that answer to integrated command structures and pursue national security policies, and have integrated economies governed by a single set of national policies."[89]

The critics of Waltz's view commonly point out that capability, no matter how effective, is not always translated into power. For instance, Stanley Hoffman described the US as a "Gulliver" tied by an international system, and hence in many instances she wears straitjacket.[90] More importantly, in today global economic system, the ownership of the means of production has become more significant than ownership of the means of destruction. The prevailing influence in the post-industrial world is measured not by guns and smart booms, but instead by the role of corporations in the global exchanges system, the strength and influence of currencies and financial institutions, and the control of budget deficits and trade balances. As Rosecrance puts it in 1986, where state once had no choice but to pursue military power, they now have a choice: they may remain political-military states, or they may have instead pursue economic power and become trading states.[91]

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[87] Hans J. Morgenthau, *Politics Among Nations: The Struggle for Power and Peace*, Fifth Edition, Revised, Alfred A. Knopf, 1978, pp. 11. The reader should note that this book was first published in 1948.

[88] Kenneth Waltz, *Theory of International politics,* McGraw Hill. 1979, Chap. 1.

[89] John McCormick, *The European Superpower*, Palgrave Macmillan, 2006, pp. 15.

[90] Stanley Hoffman, *Gulliver's Troubles, or the Setting of American Foreign Policy*, McGraw Hill, 1968.

[91] Richard Rosecrance, *The Rise of the Trading State: Commerce and Conquest in the Modern World*, Basic Books, First Edition, 1986.

Nevertheless, Waltz's significant contribution, in the content of this book, is two folded. First, he warned us against confusing the *use* of power with its *usefulness*.[92] The military power has proven useful on occasions to shape the preference of others, but its' usefulness to consolidate domination, indefinitely, over another is not sustainable in a sense that even a military occupation of a country will eventually must end. Second, he also draws attention to different between national and international politics, which compels one to consider his view is utterly bounded to the post WWII era and onward. According to him, "National politics is the realm of authority, of administration, and of law. International politics is the realm of power, of struggle, and of accommodation."[93]

Others, like Klaus Knorr, followed more or less the Morgenthau lead.[94] However, Knorr had to acknowledge that relational power alone is unable to explain the future possession of it.[95] The relevancy of Knorr's view in this book related to the fact that he underlined the important issue and noted the difference between influence that was *coercive* (actor B is affected by fear of sanctions or threats or restrictions by actor A) and influence that was *noncoercive* (B's choices are "enriched rather than limited" by A). In a coercive situation, B loses or expects to lose while A gains; in a noncoercive situation, A and B both expect to gain.[96]

Joseph Nye's distinction between "soft" and "hard" power bears striking similarity with Knorr's notion of coercive and noncoercive power.[97] According to Nye, hard power is essentially based on military and economic might, to "pursue" others to change their position. It can rest on a combination of inducements and threats.[98] Similar to the noncoercive power, the idea of soft power, Nye argues, "is more than just persuasion or the ability to move people by argument, though that is an important part of it. It is also the ability to attract, and attraction often leads to acquiescence. Simply put, in behavioral terms soft power is attractive power."[99]

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92 Kenneth Waltz, 1979, pp. 191.

93 Ibid, pp. 113.

94 Kluas Knorr in *Power and Wealth: The Political Economy of International Power* conferring power of states in international relations – reviewing the general bases of influence, e.g., wealth, skill, etc., among state actors and considered the manner in which military and economic power may be generated and used (see Kluas Knorr, *Power and Wealth: The Political Economy of International Power,* Basic Book, 1970).

95 Susan Strange, *The retreat of the State: The Diffusion of Power in the World Economy*, Cambridge University Press, 1996, pp. 18.

96 John McCormick, 2006, pp. 14.

97 Joseph S. Nye, *Soft Power: The Means To Success In World Politics*, Public Affairs, 2005. It should be noted, however, as Susan Strange points out, "the distinction is never precisely defined nor developed into a general theory of power in the international political economy." (See Susan Strange, *the Retreat of the Sate*, 1996, pp. 19).

98 However, Nye also acknowledge that sometimes persuasion based on less tangible inducements, such as shaping the preferences of others through values that others aspire to adopt.

99 Joseph S. Nye, 2005, pp. 6.

If hard power rests on *command behavior*, or the ability to change what others do by coercion or inducement, then soft power can be described as a *co-optive power*, or the ability to change what others want through either the appeal of its ideals attraction, i.e., cultural values, or manipulation of agenda.[100] In a more or less similar domain, Northedge attempted to shed some light on the different connotation of the notion of power by separating “force” from “power.”[101]

More traditional international relation thinkers perceived power in term of hegemonic tendency in the system, which perhaps is due to growing awareness, or apprehension if you would, that the system is susceptible to “crisis” that apparently perceived as an innate attribute of that system. This view is built on *hegemonic stability theory*, which developed by Charles Kindleberger who demonstrated that the stock crash of 1929 and ensuing international chaos were due to the absent of a world power capable to assume the role of global hegemon.[102] Among the subscriber of this school, some are convinced that the international system is constructed around dominant poles to the extent that international stability necessitates a recognized power that is capable of taking political and military responsibility at the global level.[103] In this sense, the world works best when it is dominant by a state, hegemonic state,[104] or as Gilpin described the hegemon’s role as “the cement that holds the system together.”[105]

Robert Dahl’s explanation of power can be perceived as a response to the traditional thinkers. Dahl thought capabilities or resources, at the local government level, are poor way of judging relative power. In his view, it is more “power over” than “power from” that matter. For instance, power derived from a military relationship, e.g., a defense agreement, is different from power derived by ideological relationship, and both are different from power over by economic relationships such as relationships between “buyer and seller, lender and borrower, producer and processor, processor and consumer, investor and entrepreneur, employer and employee,

[100] Ibid, pp. 7.

[101] For instance, Northedge in his essay, *The Use of Force in International Relation* distinguished “force” from “power” in a sense that in political science domain power usually means “the capability of a person or group to make his or its will felt in the decision-making process of another person or group… A state may be said to have power in the international system when another state recognizes that it cannot be ignored when issue have to be determine.” (See F. S. Northedge, ed, *The Use of Force in International Relations*, London, 1974, pp. 12).

[102] See Charles Kindleberger. *The World in Depression: 1929–1939*, London, the Penguin Press, 1973; “International Public Goods without International Government,” *The American Economic Review*, Vol. 76, No. 1 (Mar., 1986), pp. 8–9; and “Dominance and Leadership in the International economy,” *International Studies Quarterly*, vol. 25, no. 2, June 1981, pp. 242–254.

[103] See Robert. Gilpin,*The Political Economy of International Relations*, Princeton University Press, 1987. See also Mario. Telo, *International Relations: A European Perspective*, Ashgate Publishing, 2009, pp. 57–58.

[104] To be a Hegemon, a state must have three attributes: (1) The Capability to enforce the rules of the system; (2) The Will to do so; and (3) A Commitment to a system, which is perceived as mutually beneficial to the major states.

[105] Robert Giplin, The Political Economy of International relations, Princeton University Press, 1987, pp. 76.

and so forth."[106] Therefore, the exaggerated interest of scholars in hegemonic power is not only overly narrow, but their tendency to concentrate attention on capabilities based within a geographical area lead them to either a wrong direction or a wrong conclusion.[107] For one thing, the Hegemonic Stability Theory emerged not for the explanation of international regimes, but as a justification for the condition of international economy. Kingleberger's analysis of the Great Depression of 1929–1939 clearly confirmed this observation as he argued that "for the world economy to be stabilized, there has to be a stabilizer, one stabilizer."[108] The theory also labeled invalid by Snidal when he claims, "If the theory could be taken at the face value, it would be among the most powerful and general in all international relations. Yet its widespread use seems more closely associated with an equally sloppiness in 'applying' the theory than with any general or fundamental validity."[109]

In retrospect, and regardless of absent of general theory of power, we would like to underline the point that it is certainly possible to recognize power when it is applied and witness it execution when it is exercised. In fact, those who have been a subject to such exercise will recognize power readily than those who have it and exercised it. As Foucault stated, "Power exists only when it is put into action."[110] Or as Susan Strange observed, "this is why power is so often defined, either at the local or international level, in terms of 'resources' or 'capability'."[111]

We end this section by few remarks and a summation of the relevant points. First, we are convinced that the role of state in defining the concept of power is not only overly exaggerated but it is also outdated. History offers many examples of nonstate actors exercising power over others, the most obvious being organized religion. The encounter of Islam with human civilization, and the West in particular, dates back to 1,300 years when European areas like Spain, Portugal, Sicily, and the southern France came under Muslim jurisdictions and "experienced a thriving cultural revival that become a major influence in the transmission of civilization that sparks the European Renaissance."[112] Christianity was the primary driving force in European politics and culture for the best part of 1,500 years.[113] And quite recently, who can deny the power of al-Qaeda over the rest of the world – with its drug-running financial resources and shady identity it has single handedly inflicted heavy fiscal burden on government, change policies, and the routine of daily life of millions.

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[106] Susan Strange, "What Is Economic Power, and Who Has It?" *International Journal*, Vol. 30, no. 2, Spring, 1975, pp. 216. She further explains, "In each case, the process of deciding the balance, and therefore the outcome, is essentially a bargaining process." (Ibid, pp. 217).

[107] Susan Strange, 1996, pp. 25.

[108] Charles Kindleberger, *The World in Depression 1929–1939*, The Penguin Press, 1973, p.305.

[109] Duncan Snidal, "The limits of hegemonic stability theory," International Organization, vol. 39, no-4, Autum 1985, pp. 579.

[110] Michel Foucault, *Beyond Structuralism and Hermeneutics*, 2nd edition. Ed. Hubert L. Dreyfus and Paul Rabinow, U of Chicago Press, 1982.

[111] Susan Strange, 1996, pp. 18.

[112] John L. Esposito, *The Oxford History of Islam*, 2000, pp. 602.

[113] For discussion, see J. M. Roberts, *The Penguin History of the World*, 1990, pp. 255–67, 459–71.

Second, the outdated emphasis on states is mostly due to the fact that for the past several decades the world around us has change. We are living in the world in which the single uniform economic system is now operating at full scale. The building blocks of this system would not be states, but at best, portion of state functions such as courts, legislatures, networks, etc.[114] In short, globalization has the dual effect of displacing politics and of diffusing authority of state, and hence diminishing state's capacity to monopolized power, or in Weber's view violence. In this light, we should review our perception of the way the today world works, that is as Cox puts it, "through a series of connected structures of production relations,"[115] and thereby abandon the emphasis on nation-states and their unitary view in favor of a focus on complex and integrated global economic network. Respectively, we chose the notion of power that reflects this objective.

Therefore, power is defined as the ability of an entity (or collections of entities) to affect outcomes that their interests take precedence over the interests of others. On this issue, Waltz points out "The power of the strong may deter the weak from asserting their claim, not because the weak recognized a kind of rightfulness of rule on the part of strong, but simply because it is not sensible to tangle with them. Conversely, the weak may enjoy considerable freedom of action if they are so far removed in their capability from the strong that the later are not so much bothered by their action or much concerned by marginal increases in their capability."[116] In light of Waltz's observation, the notion of *power relationship* bears considerable weight in the global economic system, and more importantly, among actors who take on vital role in operation of the global system and able to exercise power over others. Power relationship, according to Foucault, "can only be articulated on the basis of two elements which are each indispensable if it is really to be a power relationship: that 'the other' (the one over whom power is exercised) be thoroughly recognized and maintained to the very end as a person who acts; and that, faced with a relationship of power, a whole field of responses, reactions, results, and possible inventions may open up."[117] Although violence may be a part of some power relationships, according to Foucault "In itself the exercise of power is not violence"; it is "always a way of acting upon an acting subject or acting subjects by virtue of their acting or being capable of action."[118] In short, exercise of power can be viewed as a set of actions upon other actions. In this respect, the exercise of power in the form of an effective means to gain economic advantage is not the sole privilege of ruling elites or governance bodies but "emanates from a loosely woven web of interconnected actors and institutions whose interests sustain existing conditions while allowing certain forms of discontent and resistance to emerge."[119] The ample example of such discontent is the outcries over the recent financial crisis around the world.

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114 For more detailed analysis see Anne-Marie Slaughter, *A New World Order*, Princeton University Press, 2005.

115 Robert Cox, *Production, Power and World Order*, Columbia University Press, 1987, pp. 5.

116 Kenneth Waltz, 1979, pp. 113.

117 Michel Foucault, 1982.

118 Michel Foucault, 1982, pp. 220.

119 Subhabrata Bobby Banerjee, *Corporate social responsibility: the good, the bad and the ugly,* Edward Elgar, 2008, pp. 141.

The notion of power under consideration in this book is not related to *capabilities*, but rather associated to the prevailing *power relationships* in the global economic system. In this respect, when we talk about the power of financial sector we mean to imply that global finance has the upper hand (in exercising power) over all others actors in the global system.

How Financial Institutions evolve in the Prevailing environment

We start this section by simply presenting several events in a chorological order and expert opinions that in our opinion are ample indication of the prevailing environment under which the financial institutions were helped to rise above others, including policy makers as well as the institution of government. More importantly, in the following pages, the highlighted developments suggest that during the past several decades these institutions constructed the pathological inclination that was capable to maintain enduring royalty only with shareholders and callous unconcern for others; incapable to define or experience quilt by self-promotion of deceitfulness; authenticate conning others for profit; and inability to conform to social norms with respect to lawful conducts and common ethic.[120]

In presenting these events and opinions, we mainly focused on the US economy and its financial institutions for three distinct but interrelated reasons. First, the US economy is largest in the world to the extent that it's nominal GDP is equal to the next three largest economies combined, namely, China, Japan, and Germany combined.[121] The value of goods and services produced in the USA is 23% of the value of entire global production.[122] Respectively, the US economy inherently has immense power over the rest of the world.[123]

[120] To reaffirm this observation it is sufficient to remind the reader that the Goldman Sachs CEO, who was scheduled to testify in front of the Senate Permanent Subcommittee on Investigations about the SEC lawsuit charging the firm with securities fraud, once proclaimed that investment bankers are in the business of doing "God's work." For detail see http://www.timesonline.co.uk/tol/news/world/us_and_americas/article6907681.ece?token=null&offset=36&page=4.

Moreover, similar sentiments were expressed in Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power*, Free Press, 2005.

[121] International Monetary Fund, *World Economic Outlook Database*, April 2011.

[122] However, another telling statistics is food accounts for a significant share of total consumer expenditure in many parts of the world except the USA, as the 2007 *World Economic Outlook* observed "the weight of food in the consumption basket averages more than 60% in sub-Saharan Africa, whereas it is about 30% in China, and only 10% in the United States." See pp. 13.

[123] For instance, in various global markets, e.g., oil, the US economy has *monopsony power* over the oil producing economies because "its consumption is a substantial fraction of total world production" (For detail study of this topic see Ian W.H. Parry and Joel Darmstadter, "The Costs of U.S. Oil Dependency," *Resources for the Future*, Discussion Paper 03–59, December 2003, pp. 12–14); or, as Magnuson astutely explains monopsony power is the common used strategy by large US-based corporations to pressure their suppliers into slashing their prices (see Joel Magnuson, *Mindful Economics: How the US Economy Works, Why it Matters, and How it Could be Different*, Seven Stories Press, 2008).

Second, the USA, more than any other nations in the world, is the home-based to the large financial institutions (including banks). For instance, banks that are either among the most profitable with holding assets well above trillion US dollars, such as J.P. Morgan ($2,02 trillion), or among the world largest wealth managements like Bank of America that "serves clients all over the world and has a relationship with 99% of the U.S. Fortune 500 companies."[124] Moreover, according to Alpha magazine, eight out of the ten largest and most profitable hedge fund firms in the world are based in the USA[125] The importance of the global financial institutions, which often overlooked, is that "They are strategically positioned to directly and indirectly lever more than most other businesses, expand the aggregate money and credit supplies, create debt and speculatively affect stock, commodity and real estate prices."[126] The domination of US financial sector was also noted by the Think Tank circle and International organization even before the 2008 episode.[127]

Finally, the more we examine various financial crises, particularly the 2008 episode, the more we discover how interconnected the US financial market and institutions are with the rest of the world. The cliché of a "small world" resonates. As Davidson observes, "A family defaults on its mortgage in Florida and its house repossessed, and this contributes to the write-down of a bank in Europe. The US Federal Reserve cuts interest rate and send out a message to central banks around the world."[128] Perhaps, it is not a far fetch to assert that the 2008 financial crisis signals the primacy of US financial institutions. Taking these reasons into consideration, it was easy to conclude that the USA played the significant part in triggering the global crisis. In addition, the role of financial sector in the USA and elsewhere is noteworthy, as Ferguson has observed, "In 1947 the total value added by the financial sector to US gross domestic product was 2.3 per person; by 2005 its contribution had resin to 7.7% of GDP. In other word, approximately $1 of every $13 paid to employees in the United States now goes to people working in finance. Finance is even more important in Britain, where it accounted for 9.4% of GDP in 2006."[129] Under this circumstance, one should not be surprised to see the Communist

[124] See http://www.doughroller.net/banking/largest-banks-in-the-world/.

[125] See http://www.alphamagazinerankings.com/HF100/rankings1.asp.

[126] Assaf Razin and Steven Rosefielde, "Currency and Financial Crises of the 1990s and 2000s," *NBER Working Paper no. 16754,* February 2011, pp. 2.

[127] For instance see Ehrmann, Michael, Marcel Fratzscher, and Roberto Rigobon, "Stocks, Bonds, Money Markets, and Exchange Rates: Measuring International Financial Transmission," NBER Working Paper No. 11166, 2005. In addition, IMF in its 2007 annual report, *World Economic Outlook*, also noted, "with the continued dominant role of the United States in global financial markets, cross-border spillovers from financial shocks in the United States remain a particular concern." (see IMF, *World Economic Outlook: Globalization and* Inequality, 2007, pp. 183. See also Bayoumi, Tamim, and Andrew Swiston, 2007, "The Ties That Bind: Measuring International Bond Spillovers Using the Inflation-Indexed Bond Yields," *IMF Working Paper* 07/128).

[128] Alexander Davidson, *How the global markets really work: the definitive guide to understanding the dynamic of the international money markets*, Kogan Page, 2009, pp. 2.

[129] Niall Ferguson, *The Ascent of Money: A Financial History of the World*, Penguin Press, 2008, pp. 5.

China become one of the main creditors of the Capitalist America to the extent that China passed Japan to become the US government's largest foreign creditor (the America's debt financier).[130]

The next step is to demonstrate chronologically the major developments that shaped the prevailing US financial power and consequently contributed significantly to globalization of financial sector, and hence the dominant role of the global financial institution.

In October 15, 1982, less than 2 years into his presidency, President Regan introduced one of his administration's major pieces of deregulation of America's financial institutions, known as the Garn-St Germain Depository Institutions Act.[131] The bill changed the half of century American practice of home financing and allowed Savings and Loans financial institutions, known as thrifts, to compete in the complex and highly volatile financial marketplace. As a result, a new breed of aggressive Savings and Loans emerged, whose main business was making mortgage loans within their community and attracted large pools of deposits by offering higher returns, and then used this cash to move into new lines of business, including junk bonds and real estate developments. The result was the rise in housing construction, and consequently significant increases in value of the real estate in the country.

Two years later, the simulated real estate boom came to an end and losses of speculative investments started to pile up to the extent that by 1988 were estimated at $60 billion. Soon after, Congress created a Government-owned asset management company known as Resolution Trust Corporation (RTC) to take over the assets of insolvent financial institutions.[132] The adventure of Savings and Loans ended up costing taxpayers about $124 billion.[133] It is worthy to note, and in direct contrast to the 2008 episode, the major lenders in the Saving and Loan affair were under investigation prior to the collapse.

The Saving and Loan affair sparked dynamic debates among experts and academicians in terms of vulnerability of thrift institutions and the incentive to gamble and risk taken which had led these institution to engage in fraudulent accounting. In 1993, two economists at University of California in Berkeley suggested that, "an

[130] This development, unlike the popular view, is also presents dangerous case for China since China is now holding US dollar for than any other nation, and hence to certain extent its well being is dependent on how well dollar is value in the world market.

[131] For detail information of the act see: http://realestate.bryanellis.com/52/garn-st-germain-depository-institutions-act-of-1982/.

[132] According to the New York Times, "Resolution Trust closed or reorganized 747 institutions holding assets of nearly $400 billion. It did so by seizing the assets of troubled savings and loans and then reselling them to bargain-seeking investors. At the peak in early 1990 there were 350 failed savings and loan institutions under the agency's control." (see "Saving and Loans Associations," *The New York Times*, Tuesday, May 10, 2011).

[133] It is noteworthy to mention here that when someone says "the cost to taxpayers is $… amount," one should immodestly ask what does it imply; what will happen to this money, where the money goes, who received it and why? These are the questions that are often neglected but bear significant weight in understanding the situation. For an informative discussion, see http://start-business-loans.com/blog/personal-credit/24/.

economic underground can come to life if firms have an incentive to go broke for profit at society's expense (to loot) instead of to go for broke (to gamble on success). Bankruptcy for profit will occur if poor accounting, lax regulation, or low penalties for abuse give owners an incentive to pay themselves more than their firms are worth and then default on their debt obligations."[134] Nevertheless, regulatory changes of 1980s continued well into 1990s, first with the Interstate Banking and Branching Efficiency Act of 1994 and later the 1999 Financial Service Modernization Act. According to Saunders, however, these changes, which included, "lifting the regulatory barriers to lend or to entry or on products offered, exposed financial institutions to risk or sudden collapses and unexpected changes in financial market."[135]

Despite the thrifts financial collapse and warnings by professionals in the financial discipline the popular trend continues, as if *All Quiet on the Western Front*. Participants of the popular culture also strengthened the euphoria of easy money. In 1998, Jeremy J. Siegel, the author of best-selling book advice the public that, "Stocks should be constitute the overwhelming proportion of all long-term financial portfolios."[136] And to make sure everyone understand the notion of long term he further elaborated that "portfolio composition is crucially dependent on the holding period of the investor, and holding periods are often far longer that most investor realized." And yet, even within such tamed and contented climate red flags were raisin by foes and die-hard supporters of financial deregulation, signaling the apprehension of what may occur.

In 2000, *Economist* claimed that it "has long argued that the American economy is suffering from a financial bubble."[137] During the same year, the Yale economist Robert Shiller also warned the vulnerability of economy to financial speculations.[138] Soon thereafter, the stock market crashed, also known as the dot-com bubble crash, which caused the loss of $5 trillion in the market value of various companies.[139] According to Wall Street insider, *Bull Investor*, the main causes of crash was corruption and fraudulent practices – a lot of companies inflated their profits by means of

[134] George A. Akerlof, Paul M. Romer, "Looting: The Economic Underworld of Bankruptcy for Profit," *Brookings Papers on Economic Activity*, Vol. 1993, No. 2 (1993), pp. 2.

[135] Anthony Saunders, *Financial Markets and Institutions: A Modern Perspective*, 2nd edition, McGraw-Hill, 2003, pp, 543.

[136] Jeremy J. Siegel, 2nd edition, Stocks for the Long Run, McGraw-Hill, 1998, pp. 361.

[137] Economist, "A hard landing? The risk of a hard landing in America is real," *Economist*, Dec 7th 2000.

[138] Robert Shiller, *Irrational Exuberance*, Princeton, University Press, 2000. Shiller also points out, "In 2000, at the peak of the market, it become popular to refer the *Greenspan put*. Many thought that Greenspan was so supportive of the shock market that his presence as Fed chair was as good as having a put option on the stock market to protect us from stock market declines. The rationale behind this talk of the Greenspan put was that Greenspan had used his power to prevent a stock market debacle" (ibid, pp. 40).

[139] http://articles.latimes.com/2006/jul/16/business/fi-overheat16.

fraud and accounting loopholes and hid their debt.[140] The fraudulent accounting practices were so popular that Forbes published, *the Corporate Scandal Sheet*, stating, "With the avalanche of corporate accounting scandals that have rocked the markets recently, it's getting hard to keep track of them all – but our Corporate Scandal Sheet does the job."[141]

The stock market crash followed by recession, as Samuelson famously noted, "The stock market has predicted nine of the last five recession."[142] The recession forced the Fed to cut interest rate to offset the collapse of investment, as the conventional wisdom prescribed. The Fed curtailed short-term interest rate from 6.5 in January 2001 to unprecedented level in the post-1971 era of floating exchange rate of 1% by June 2003. As a direct result of Fed action, credits become widely available, housing construction picked up and real states started upward trend again as more people found they could afford the lower mortgage payment. Indeed, Rajan argument "let them eat credit" could well summarize the mantra of the political establishment in the go-go years before the crisis.

In April of 2004, the five member of the Securities and Exchange Commission (S.E.C) met to consider the proposal put forward by the five powerful investment banks, asking the Commission to change "the net capital rule." The five banks, led by Goldman Sachs, which was headed by Henry M. Paulson Jr, who 2 years later left Goldman Sachs to become Treasury secretary. According to New York Times, "They wanted an exemption for their brokerage units from an old regulation that limited the amount of debt they could take on. The exemption would unshackle billions of dollars held in reserves as a cushion against losses on their investment. Those funds could then flow up to the parent company, enabling it to invest in the fast growing but opaque world of mortgage-backed securities; credit derivatives, a form of insurance for bond holders; and other exotic instruments."[143] The proposal was approved and the decision was complete and published in the Federal Register a few months later.[144] The 2004 decision, more than anything else, reflected the view that taming Wall Street pedagogical pursue of overindulgence was a thing of the

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[140] For instance, on June of 2002, WorldCom, the Nation's second largest long distance telecommunications company and 42nd among Fortune 500 companies, was found practicing illegal accounting practices by overstated earnings in 2001 and the first quarter of 2002 by more than $3.8 billion. A month later, and $11 billion collapse forced WorldCom filed for corporate bankruptcy, the largest bankruptcy in US history at the time. http://www.bullinvestors.com/stock-market-history. It should be noted that WorldCom's external auditor during and before the fraud-case was Ather Anderson, the same firm was also audited Enron and convicted of accounting fraud.

[141] http://www.forbes.com/2002/07/25/accountingtracker.html.

[142] Paul Samuelson, "Science and Stocks" *Newsweek*, September 19, 1966.

[143] The New York Times, Agency's 04 Rule Let Banks Pile Up New Debt, New York Times, (October 2, 2008). The article can be access at: http://www.nytimes.com/2008/10/03/business/03sec.html?em=&pagewanted=2.

[144] Ironically, the decision was intend to ease regulation that the EU was about to impose on the foreign operation of US investment banks.

past and both Washington regulatory interests and Wall Street interests have converged. How else one can explains the conduct of the Commission that was created to "catch thief."[145] Few months later, on September 2004, a top FBI official claimed that fraud is running rampant in the nation's mortgage industry, with nearly three times as many reports of suspicious activity so far this year compared with 2001. *"It has the potential to be an epidemic,"* said Chris Swecker, FBI assistant director for criminal investigations.

A year later, another warning was delivered at a celebration honoring Alan Greenspan, who was about to retire as chairman of the US Federal Reserve. Raghuram Rajan, an insider of the global financial system, presented a paper called "Has Financial Development Made the World Riskier?" in which he argued that because banks were holding a portion of the credit securities they created on their books, if those securities ran into trouble, the banking system itself would be at risk. Banks would lose confidence in one another, he said: "The interbank market could freeze up, and one could well have a full-blown financial crisis."[146] More importantly, he also suggested that change in financial sector have change financiers' incentive, which in turn have alter the essence of risk taken undertaken by the system to the extent that there is rich rewards for making money, but no penalized for losses. Such skewed incentive encouraged financial institutions to engage in complex products with potentially big payoffs, which could, and in fact has, fail spectacularly. Rajan's observations hinted at an unwelcome but a plausible outcome, and hence evoke responds that were hastily made. For example, former Chief economist at Obama administration, which also carries number of titles such as former US Treasury Secretary and former Harvard President, Lawrence Summers told the audience that he found "the basic, slightly lead-eyed premise of [Mr. Rajan's] paper to be misguided."[147]

Before concluding this section, few issues must be clarified. First, an important issue that rarely investigated, with few exceptions, in all these developments and analyses is the fact that banks, by the nature of their lending and borrowing practices, bear significant vulnerability in terms of cash shortages, since *banks tend to borrow short and lend long*. Traditionally, banks' borrowing is based on deposits, and hence can be redeemed on relatively short notice. However, the loans they make are mostly based on long-term basis like mortgages, and hence can be difficult to convert into cash on the short notice. For instance, if for some reason, all depositors

[145] The phrase refers to President Roosevelt comment – "When President Franklin D. Roosevelt was asked in 1934 why he appointed Joseph P. Kennedy, a spectacularly successful stock speculator, as the agency's first chairman, Roosevelt replied: 'Set a thief to catch a thief.' (See The New York Times, Agency's 04 Rule Let Banks Pile Up New Debt, New York Times, October 2, 2008)."

[146] Raghuram G. Rajan, "Has Financial Development Made the World Riskier?" *NBER Working Paper* No. 11728, November 2005, pp. 346.

[147] Paul Krugman, "How Did Economists Get It So Wrong?" *New York Times*, September 2, 2009.

simultaneously try to withdraw their funds at once (technically called bank run, trouble ensue in a sense that the bank might simply not be able to pay off all its depositors). The Lehman bankruptcy case in 2008 is an ample example of such episode.[148]

Second, the above developments and policies provided an environment that can facilitate institutionalization of an industry like the financial industry, which function through a feedback loop that ultimately would leads toward its instability and demise.[149] On the one hand, the industry operates under weak set of rules against fraudulence conducts, which incline to invite dreadful practices, e.g., Alt-A loan[150]

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[148] Lehman borrowed significant amounts to fund its investing in the years prior to its bankruptcy on September 15, 2008. A significant portion of this investing was in real-estate-related assets such as subprime and other lower-rated mortgages, making it vulnerable to a abrupt shock or downturn in that market (The reader should note here the time dimension of assets and liabilities. A 30-year mortgage, for a bank, is a long-term asset. They will get a mortgage payment every month for 30 years and, most importantly, they can't call in the loan before then; that is to say they can't demand that the homeowner pay it back. On the other side, banks have liabilities with different maturities, i.e., deposits (savings accounts) can be withdrawn at any time, so their maturity is essentially instant).

The situation was also exacerbated by the 2004 decision, which changed the net capital rule, powerful investment banks like Lehman were exempt to the same regulations applied to depository banks to restrict their risk-taking.

[149] In a general term, Institutionalization involves the processes by which social processes, obligations, or actualities come to take on a rulelike status in social thought and action. For example, a *No Smoking* sign is an institution with legal status and implication as well as an attempt to regulate behavior. However, we applied the term here to imply a process which alters an industry's code of conduct, mission, policies, vision, and strategic plans into guidelines applicable to the daily activities of its employees, from the top to the bottom as well as the interaction with the external environment. It aims at transferring fundamental values and objectives into new industrial's culture and structure.

[150] Alt-A loans are primarily credit-score driven, since the candidates for these loans tend to lack proof of income from traditional employment. The Alt-A loan reduces the gathering of documentation associated with fully documented loans, such as providing income verification and documentation of assets. On the contrary, borrowers do pay a slightly higher interest rate than fully documented loans. In short, the common verification process was gutted for sake of making more loans. We know that this process will produce enormous fraud, under economic theory, criminology theory, and 2000 years of life experience.

One of the main mortgages that fall into the Alt-A category of mortgage lending is Liar Loans. According to INVESTOPEDIA, "These loan programs are designed for borrowers who have a hard time producing income and asset verifying documents, such as prior tax returns, or who have untraditional sources of income, such as tips, or a personal business. These loans are called liar loans because the SISA or NINA features open the door for abuse when borrowers or their mortgage brokers or loan officers overstate income and/or assets in order to qualify the borrower for a larger mortgage." The 2008 episode was filed with these types of loans. For instance, IndyMac specialized in making liars' loans. In 2006 alone, it sold $80 billion dollars of liars' loans to other companies. In 2009, the Federal Deposit Insurance Corporation announced that it had completed the sale of IndyMac and sustained a $10.7 billion loss.

and abusive accounting.[151] On the other hand, these attributes are most likely lead to "superior opportunities for growth because they produce the kind of (fictitious) profits and net worth"[152] that render even stronger incentive for investors and creditors to engage in even more unethical activities and hence perpetuates the vicious cycle.

Finally, the events and developments of the last 3 decades have drawn our attention to the issues that are not only significant to the content of this book, but also bear great important for the globalized world and global governance; the issue of transparency, accountability and the rule of law. And yet, a sketchy review of popular media as well as academic analyses on recent financial misdeeds including the 2008 financial episode would reveal the fact the issues of transparency, accountability and the rule of law are either excluded, neglected or at best mentioned in a blurrily manner. Such absence is particular alarming since these concepts constitute the backbone of democratic societies, but appear to have suffered more from the financial crisis than conducts of authoritarian regimes and renegade states.

Ironic as it may seems, the 1980s start with "Trust, but verify" slogan, which was a signature phrase adopted and made by former US president Ronald Reagan. However, the narrative of "trust, but verify" entails transparency, which conspicuously was not present for the last several decades, particularly during the 2008 episode. The absence of transparency can be illustrated by the need to know facts about how bad the conditions of the banks are? For instance, we need to know how much toxic assets are out there; how much the rescue banks' assets are worth; and how much they should be sold for. Furthermore, how many banks are insolvent, such that we had rescued them in such hasty and controversial manner? It is a contradiction in term when you asked for $2 trillion taxpayer dollars to deal financial meltdown, as Secretary Geithner did publicly, meanwhile allowing all the big banks to report that they're not only solvent, but fully capitalized. Both statements can't be true. It can't be that the banks need $2 trillion, because they faced massive lost, and that they're solvent. These are practical issues which one needs to know to make educated decision about possible causes and impact of the crises with such magnitude. The more public the information is made, the faster this whole crisis will be

[151] This observation has been substantiated by various sources, particularly by insiders like Guy Hands, a global financiers, who placed part of the blame for the current liquidity crisis on governments, saying that while borrowing by both individuals and institutions soared, loans were allowed to slowly become too generous in their terms, "Governments have had a vested interest in making everything appear rosy, and thus have encourage ever increasing borrowing as the alternative would have been a slowdown in growth." (See Mathieu Robbins, "Guy Hands' Xmas gift compares market now to 1929," *Reuters*, Monday December 17, 2007. Available at: http://www.reuters.com/article/2007/12/17/us-hands-idUSL1751976620071217).

[152] William Kurt Black, *The Best Way to Rob a Bank Is to Own One: How Corporate Executives and Politicians Looted the S&L Industry*, University of Texas Press, 2005, pp. 7.

solved, and then everyone can move on to fixing the damage being done to the real economy.[153]

The important question is this: would greater transparency have helped stave off the 2008 financial crisis? There is more and more evidence that it might have, and more and more voices calling for a new approach moving forward. For instance, Transparency International, the world's most-respected anticorruption NGO, called upon the leaders of the Group of 20 (G-20) industrialized nations, "to ensure that transparency, integrity and public accountability become the foundation of the vital reforms needed to rebuild the world's financial system."[154] The sentiment also appeared in the declarations by the G20 Summits held in Washington in 2008, in London and Pittsburgh in 2009, and in Toronto and Seoul in 2010.

The links between financial crisis and the need for more transparency is also related to the nature of modern financial transaction and the way people perceived what money is. On the former, an ample example is Derivatives. Derivatives are financial instruments whose value is derived from something else – the weather, or interest rates, or the likelihood that a borrower will default on a loan. They're largely traded over-the-counter, which basically means that one banker picks up the phone and calls another banker, and they make a deal. In this respect, nobody really knows what derivative contracts are out there, or how much risk any bank is taking on. That is how a big bank collapses.

On the latter, a bit of elaboration is needed. The 2008 episode clearly underlined the importance of money as social phenomenon and relationship, the concept that was introduced brilliantly by Tobin and later by Hahn.[155] They explain money, like language, as a means of communication, which owes its value to its general acceptance by individuals. In terminological domain of economics, we can say that money is socially accepted because it is endowed with a positive purchasing power, or as Hahn claims, "a positive exchange value." In this respect, money is merely a relationship of trust between certain parties that enables trade. If one trusts this piece of paper is worth a certain amount, one would engages in an exchange with another (the opposite is also true). Indeed, significant portion of the problem we are facing

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[153] The is an argument against dissemination of information, which suggests that such information drives depositors to run for an exit in a sense that they incline to withdraw their deposits from the banks all at once, a phenomenon known as "bank run." However, the counter argument in this case is the government can take over banks, the approach selected in many European economies, instead of bailing them out. In this respect, facts can be published and the public can judge for themselves how bad the financial situation is.

[154] See http://www.transparency.org/news_room/latest_news/press_releases/2008/2008_10_30_amm_financial_crisis.

[155] See James Tobin, "Discussion of Overlapping Generations Models" in J. H. Kareken and H. Wallace (eds) *Model of Monetary Economics*, Federal Reserve Bank of Minneapolis, 1980; and Frank Hahn, first edition, *Money and Inflation*, Basil Blackwell, 1982.

today is due to a lack of clear and *trustworthy* information, or simply put the absence of transparency. Significant portion of population is quite sure what anything is worth, which in turns makes any sort of trade difficult. Money only works when there's a trusting relationship, and such trust can only build when there is a reasonable flow of information to the parties involved, such that they're confident that what they have (or what they're trading for) has value.[156] In fact, the subprime crisis was begun where people realized they had no idea what everything was worth and it escalated from there.

The lack of accountability and respect for rule of law among policy makers and public officials is also striking features of various financial episodes, particularly in the latest episode. This is an astonishing development, given the extent as well as the magnitude in which the 2008 affairs affected significant portion of the population. With few exceptions, no governmental officials, including policy-makers or member of Congress or Senate, take responsibility of the past erroneous decisions or wrong doing, which shattered life of millions, and cost the country unprecedented financial burden.[157] This is mostly due to the fact that a meticulousness of policy formulation is replaced either by a sheer elitist mind-set, or/and a silly case of self-serving amnesia.

An ample example of former appeared in an interview between Mr. Summer and the New York Times, in which he defends his record by saying, "Did we 10 years ago foresee everything that happened with respect to derivatives? Absolutely not. Would I have acted differently with the benefit of everything that I've seen over the last 10 years? Of course."[158] Little the veteran policy makers and prominent economists realized that the rationale he used to defend his record, that is, *if we only knew*, is the exact rationale that would convict him. How else a policymakers meet the minimum requirement of his/her job and served the people who elected him/her, but to know the impact of a policy he/she designed? How else one separates a policy advocate from policy-makers, but to distinguishing advocacy that bears no responsibility from

[156] As Mike Masnick quite elegantly observed, "The problem over the last few months (or, for some, years) is this realization that the information they [individuals] had was bad, and they could not trust it, and thus, the "relationship" that made thing valuable disappeared. Without this trust, plenty of things that *do* have value are being severely undervalued, because there's no (or very little) credible information, and that's leading to panic, because no one is sure what anything might actually be worth." See http://www.techdirt.com/articles/20081130/2031042973.shtml.

[157] As an exception, one can name Scott Polakoff, interim director of the Office of Thrift Supervision (OTS) begun his testimony in US Senate in 2009 by stating, "It's time for the OTS to raise their hand and say they have some responsibility and accountability here. We were deemed an acceptable regulator for both U.S. and domestic and international operations." It was acceptance of mistake, in which Polakoff was clearly saying, "Blame us." (see Chana Joffe-Walt, "Regulating AIG: Who Fell Asleep On the Job?" *NPR*, June 5, 2009, at http://www.npr.org/templates/story/story.php?storyId=104979546).

[158] New York Times Magazine, May 15, 2011, pp.14.

policymaking that necessarily entails responsibility.[159] Mr. Summer's persistent refusal to take responsibility for policies he, and others in the inner circle, advocates and fought for 20 years truly makes one wonder about the notion of ethic and code of conduct within the institutions of government.

Secretary Geithner's testimony provides an excellent conformation of the latter case. On March 26, 2009, Mr. Secretary claimed that in his previous job, as president of the Federal Reserve Bank of New York, "never been a regulator, for better or worse. And I think you're right to say that we have to be very skeptical that regulation can solve all of these problems." Needless to say, if Mr. Secretary has bothered to look at the New York Federal Reserved stated objective, he would see that "As part of our [NY Fed] core mission, we supervise and regulate financial institutions in the Second District. Our primary objective is to maintain a safe and competitive U.S. and global banking system."[160]

The set of circumstances under which the rule of law was not pursued (violated) suggest even more clear infringement of the principles of a democratic society as well as democratic governance. The policy makers, those responsible to up held the law violated the rule of law. For instance, the former Secretary Paulson's conduct, in addition to entire governmental body including Congress and Senate, during the first phases of 2008 financial episode is ample illustration of clear violation of US Federal law called the Prompt Corrective Action Law (PCA)[161] when they refused to obey its mandates and placed the insolvent banks into receivership,[162] as the PCA required.[163] The implication of such clear violation is severe, not only for the USA

[159] Moreover, the claim that one could not possible "foresee everything" is really a poor justification for enormous bad decisions that have been made through many years of complacency that eventually led to self-defeating prophecy. For one thing, financial calamities did not appear out of thin air and any student of economics should, at least, be aware of the 300 year history of financial crisis. In addition, many experts and nonexperts warned against incoming collapse that often disregarded as misguided view or irrelevant. For instance, and as we mentioned earlier, Nobel prize-winner economists George Akerlof and Paul M. Romer predicted in 1993, the financial giants would used CDS until the system crashed, knowing that the taxpayers would bail them out when the crash happened.

[160] See Newyorkfed.org.

[161] The PCA "mandating progressive penalties against banks that exhibit progressively deteriorating capital ratios. At the lower extreme, a critically undercapitalized Federal Deposit Insurance Corporation (FDIC)-regulated institution (i.e., one with a ratio of total capital/assets below 2%) is required to be taken into receivership by the FDIC in order to minimize long-term losses to the FDIC. The motivation behind the law is to provide incentives for banks to address problems while they are still small enough to be manageable." To learn about the History of the law, see http://www.pcanet.org/general/history.htm.

[162] According to INVESTOPEDIA, The responsibility of the receiver is to recoup as much of the unpaid loans as possible. Being in receivership is not an enviable situation for a company. Oftentimes, receivers find that the best way to pay back loans is to liquidate the company's assets, which effectively puts the company out of business. According to Saunders and Cornet, "receivership is mandatory even before the book value ratio falls to 0%." (see Anthony Saunders and Marcia Cornet, *Financial Institutions Management: A Risk Management Approach*, McGraw-Hill/Irwin; 7 edition, 2010, pp. 522).

[163] See William K. Black, "Why Is Geithner Continuing Paulson's Policy of Violating The Law?" *HUFFPOST Business*, February 23, 2009. It can be accessed at http://www.huffingtonpost.com/william-k-black/why-is-geithner-continuin_b_169234.html.

but also for the entire global system. As William Black observed, "In the Savings and Loan debacle, we developed excellent ways for dealing with the frauds, and for dealing with the failed institutions. And for 15 years after the Savings and Loan crisis, didn't matter which party was in power, the U.S. Treasury Secretary would fly over to Tokyo and tell the Japanese, 'You ought to do things the way we did in the Savings and Loan crisis, because it worked really well. Instead you're covering up the bank losses, because you know, you say you need confidence. And so, we have to lie to the people to create confidence. And it doesn't work. You will cause your recession to continue and continue.' And the Japanese call it the lost decade. That was the result. So, now we get in trouble, and what do we do? We adopt the Japanese approach of lying about the assets. And you know what? It's working just as well as it did in Japan."[164]

All things considered, as long as the issues of transparency, accountability and respect for the rule of law are not taken into account, popular analyses continually to point in different directions and sometime underline less relevant factors such as behavioral deviant like a mere "greed," lack of liquidity by investment financial institutions, absent of regulatory framework, or even individual bankers, CEOs, as the root cause of the financial meltdown may confusing the effect with the cause. Indeed, the prevalence of these type of analyses are raising so fast that one may thinks that their analytical objective bear no relevancy to the main causes, and hence they rather made to draw attention away from the main cause.[165] For instance, the standard line on what went wrong with insolvent financial institutions fell into some sort of "regulatory gap." From members of Congress to Federal Reserve Chairman Ben Bernanke, the narrative was clear: Hundreds of regulators around the globe missed the calamity in the making because none of them was watching over the whole country. But such narrative failed to stand against facts, especially when one considers the facts about regulatory agencies and financial institutions. For one thing, banks choose their regulators – they go shopping and pick regulators that are more sympathetic to their business modules and overall objectives. Moreover, regulators want to get picked, because banks pay them for the service of regulation.[166] Similarly, financial institutions employ rating agencies, instead of outside party, to assess their products and services as well as their overall stability and robustness. It must be obvious that while "regulatory gap" existed, the cause of the crisis is the power of financial institutions to operate at well – with almost no strain attached and no credible supervision.

[164] See Bill Moyers Journal: William Black Interview at: http://www.pbs.org/moyers/journal/04032009/transcript1.html.

[165] We were inspired by the following, "The President is very much a figurehead – he wields no real power whatsoever. He is apparently chosen by the government, but the qualities he is required to display are not those of leadership but those of finely judged outrage. For this reason the President is always a controversial choice, always an infuriating but fascinating character. His job is not to wield power but to draw attention away from it." (See The Hitchhiker's Guide to the Galaxy, 2005.)

[166] Chana Joffe – Walt, "Regulating AIG: Who Fell Asleep on The Job," *NPR*, June 5, 2009 at: http://www.npr.org/templates/story/story.php?storyId=104979546.

Financial Institutions and Exercise of Power

To explain how financial institutions exercise power over others, one must clarify how they obtain power and then how they sustain such power over time. In doing so, to ascertain all factors involved is certainly beyond the scope of this book, and hence we only underline factors that are related to the topic of the book. Respectively, we have used various studies and experts opinions on the subject matters as well as plenty of common sense and a bit of economics.

To understand how financial institutions obtain the power we must first explain the traditional function of financial institutions, particularly banks, as a monetary intermediation.[167] From purely monetary point of view, "banks provide the economy with the numerical instrument necessary to carry out its various transactions. Nominal money is, first of all, a unit of account, whose function is to make real output homogeneous by providing it with purely numerical expression."[168] In this respect, banks monetize current output by issuing the numerical units. Since numerical instrument, nominal money, have no intrinsic value, bank can freely issue any amount of nominal money required by the economy.

However, as banks (and financial institutions) moved their activity outside their traditional role and involve in various schemes, e.g., off-balance sheet,[169] they gained ability to create "capital," "assets," and "wealth"[170] to the extent that numerical

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[167] According to Cencini, "Monetary intermediation consists in supplying the economy with numerical instrument (the ticket) by means of which goods can be (economically) *counted*." See Alvaro Cencini, Monetary Theory: National and International, Routledge, 1995, pp. 21. In nutshell, banks "play the role both of supplying the economy with the numerical vehicle required for the measurement and the circulation of current output, and of fostering its (economic) consumption through the loan of the deposited income." (Ibid).

[168] Ibid.

[169] Off balance sheet (OBS) activities "include issuing various types of guarantees (such as letter of credit), which often have a strong insurance underwriting element, and making future commitments to lend. Both services generate additional fee income for banks. Off-balance sheet activities also involve engaging in derivative transaction – future, forward, options and swaps. Under current accounting standards, such activities are not shown on the current balance sheet. Rather, an item or activity is an *off-balance sheet asset* if, when a contingent event occurs, the items or activity move onto the asset side of the balance sheet or an income item is realized on the income statement. Conversely, an item or activity is an off-balance sheet liability if, when a contingent event occurs, the item or activity moves onto the liability side of the balance sheet or an expense item is realized on the income statement." (See Anthony Saunders, Marcia Cornett, 7th edition, *Financial Institutions Management: A Risk Management Approach*, McGraw-Hill/Irwin, 2010, pp. 32). For more information on off-balance sheet activities see Anthony Saunders, Joshua Ronen and Ashwinpaul C. Sondhi, editing, *Off-Balance Sheet Activities*, Quorum Books, 1990.

[170] Here what we mean by wealth is not what economists like Henry George defined in his book *Progress and Poverty*, which claimed wealth is produced by labor, but rather what most understand of wealth and quite recently acknowledge by economists like Raghuram G. Rajan, who observed, "the industry's entire system of values uses money as the measure of all things." (See Raghuram G. Rajan, 2010, pp. 153).

instrument (nominal money) mysteries turns into real store of value. This metamorphosis monetization not only refutes the process that identified the bank money (the numerical instrument) with an asset-liability,[171] but it is also changes the nature of banking and their practices.[172] As Saunders and Cornett observed, there has been a sudden drop of business loans (as a proportion of the balance sheet) since 1990. "This drop has been mirrored by an offsetting rise in holding s of securities and mortgages. These trends reflect a number of long-term and temporary influences. One important long-term influence has been the growth of the commercial paper market, which has become an alternative funding source for major corporations. Another has been the securitization of mortgages – pooling and packaging of mortgage loans for sale in the form of bonds."[173] Curry, Fung, and Harper also confirmed these trends and observed, "The diminishing role of traditional banking is reflected in the increased migration of financial activity off-balance sheet. Loan securitization is an example."[174]

Off-balance sheet basically means that money issued (disbursed credits) by banks is not acknowledgement of debt, as it should be.[175] Rajan observed, "Securitization allowed bank to get the risky loans off its books."[176] Keeping debt off the balance sheet may sees beneficial to a institution's position in the financial market, but it also expose financial institution as well as participants in financial markets to high-risky attributes, which can easily spread throughout the economy.

Off balance activities also blurred the issue of *transfers of financial assets*, and consequently entail disclosure requirements that including transparency and accountability amendments.[177] Moreover, under the present structure of financial institutions,

[171] For a detailed analysis of this subject see Alvaro Cencini, 1994, pp. 11–15.

[172] Traditionally, banks "are entrusted with the double function of issuing the vehicular (nominal) money required for the circulation of output, and of lending the income (real money) generated by production and entered by them as a bank deposit." (see Alvaro Cencini 1994, pp. 3).

[173] Anthony Saunders, Marcia Cornett, 2010, pp. 29.

[174] Elisa A. Curry, Justin G. Fung and Ian R. Harper, "Multinational banking: historical, empirical and case perspectives" in A.W. Mullineux and Victor Murinde, edited, *Handbook of International Banking*, Edward Elgar Publishing limited, 2003, pp. 52.

[175] Based on accounting principle, money flows back to its point of origin at the very instance it is issued – banks acknowledgement of debt is lent to firms, who transfer it to workers, who earn it as a claim to a bank deposit. Thus, in the process of monetary integration money is simultaneously created, associated with current output and destroyed, in a circular movement that leaves a book-keeping defining the value of currently produced goods and services (See Alvaro Cencini, 1995, pp. 21).

[176] Raghuram Rajan, 2010, pp. 2.

[177] In fact, Financial Accounting Standard Board (FASB) adopted Financial Accounting Standard No. 166: *Accounting for Transfers of Financial Assets* in June 2010 to end widespread off-balance-sheet treatment of securitized assets, most notably failing loans that were changing hands beyond the view of investors. At the same time, it adopted FAS 167: *Amendments to FASB Interpretation No. 46R* to give new direction on when a company should consolidate a special purpose entity, or add it to the parent company's balance sheet. (see http://www.complianceweek.com/fasb-codifies-new-rules-on-off-balance-sheet-vehicles/article/189488/).

"credit or default exposure is a major risk faced by modern bank managers. Because commercial banks are highly leverage, and therefore hold little equity compared to total assets, even a relatively small amount of loan default can wipe out the equity of a bank leaving it insolvent."[178] Taken into consideration various financial crises of the past decades, either at national or global level, the critics can claim that this observation is accurate description what often had happened. Further reaffirmation of this claim comes from Reinhart and Rogoff, in which they described the 2007–2008 implosion of the US financial system, "came about precisely because many financial firms outside the traditional and regulated banking sector finance their illiquid investment."[179]

And yet, the ingenuity of financial institution in providing speculation opportunities is second to none. The inventiveness of financial institutions is their ability to identify, or create, various instruments to broaden participation in various financial markets, and hence increase speculative actions. For instance, call option, or simply call, is one way to leverage one's investment. Leveraging is any technique that increases the potential yield as well as risk of an investment. These devices facilitate the augmentation of market domains as well as ensure broad participation in the markets. The larger participation in larger markets literally transfers to greater power for financial institutions.

However, before we close this section we would like to emphasize on the fact that changing the nature of currency bears much profound consequences. On this note, we only allude to Keynes who observed, "Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in million is able to diagnose."[180]

The next question is this: how financial institutions obtained their power? First, these institutions gained power through usage of technological innovations, which we underlined above. However, another important area where technology has impacted customer services is in banks' ability to provide cash management or working capital services.[181] According to Office of Technology Assessment Report, "Information processing and communication technologies are being used to enhance existing services, to implement new ones, and to make them available in new ways. Money market mutual funds, operated by investment companies and securities broker/dealers, permit shareholders to redeem shares by writing the equivalent of a check. Banks, depending heavily on information processing and communication technologies, are beginning to offer securities through discount brokerage subsidiaries. Banks, credit

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178 Anthony Saunders, Marcia Cornett, 2010, pp. 30.

179 Ibid, pp. 145.

180 John Maynard Keynes, *The Economic consequences of the peace*, Harcourt, Brace and Howe, 1920, pp. 236.

181 For a detailed and comprehensive analysis of this subject see Anthony Saunders, *Financial Institutions management: A Modern Perspective*, Irwin, 1994, ch.10.

unions, and savings and loan associations join networks of automated teller machines that enable account holders to obtain cash 24 h a day from machines that are available nationwide."[182]

Second, according to Saunders and Cornett, the current accounting standard help banks to earn additional income and avoid regulatory costs or "taxes" since reserves requirements and deposit insurance premiums are not levied on off-balance-sheet activities. "Thus, banks have both earnings and regulatory 'tax-avoidance' incentive to undertake activities off their balance sheet."[183] Third, through favorable policy e.g., *Financial Services Modernization Act of 1999*, commercial banks, investment banks, securities firms and insurance companies were able to consolidate, and hence to realigned themselves into what is commonly referred to as *financial conglomerates* – "groups of financial institutions and firms that offer a wide range of services." These institutions are characteristically giant and complex organizations operating across the globe. Citigroup, HSBC and the ING-group are just some of the well-known active conglomerates worldwide. Indeed, such consolidation, which commonly taken place among firms engaged in the provision of wholesale financial services, has been the driving force behind the globalization process.[184]

Fourth, financial institutions influence on policy-makers and policy designs through various means, most importantly, lobbying. The most common manner in which such influence occur is described by Roubini and Mihan, "Many of them [government employees] then move back to the private sector and use their government connections to lobby in favor of looser regulation and more lax supervision of financial firms."[185] Roubini and Mihan further elaborate, "They [government employees] insulate the financial system from regulatory meddling and starve agencies of the taxpayer necessary to implement regulation. In exchange, financial firms funnel massive amounts of money towards candidates – $311 million in 2008 alone." Perhaps that is why the reforms introduced by President Obama in early 2009 have banned government employees from lobbying activities for 2 years. Along the same line of thinking, Saunders and Walter observed, "bank and other financial institutions are in an excellent position to convert them [financial institutions] into political power… They are often exceedingly well connected politically, and their lobbying power motivated by protectionist drives can be awesome."[186] The chair of the Congressional Oversight Panel for TARP, Elizabeth Warren, explained that banks and their lobbyists are hammering Congress and fighting against the interests of American families by blocking financial reform.[187] Recently, Sheila Krumholz,

[182] Office of Technology Assessment, 1988, pp. 3.

[183] Anthony Saunders, Marcia Cornett, 2010, pp. 32.

[184] See Group of Ten, *Report on Consolidation in the Financial Sector*, Bank for International Settlements, Switzerland, 2001.

[185] Nouriel Roubini and Stephen Mihm, *Crisis Economics; A Crash Course in the Future of Finance*, Penguin Group, 2010.

[186] Anthony Saunders, Ingo Walter, *Universal Banking in the United States: What could we gain? What could we lose?* Oxford University Press, 1993, pp. 21.

[187] See http://www.huffingtonpost.com/2010/02/20/elizabeth-warren-its-bank_n_469939.html.

Executive Director of Center for Responsive Politics, said, "Even though some financial, insurance and real estate interests pulled back last year [2009] they still managed to spend more than $450 million as a sector to lobby policymakers. That can buy a lot of influence, and it's a fraction of what the financial sector is reaping in return through the government's bailout program."[188] Simon and Kwak also observed, "As of October 2009, 1,537 lobbyists representing financial institution," which outnumber consumer groups, unions, and other supporters of stronger regulation twenty-five to one.[189] To this figure, Kevin Conner also add, "243 lobbyists for six big banks and their trade associations used to work in the federal government – 202 in Congress, the rest in the White House, Treasury, or at a relevant federal government agency. That's equivalent to 40 *revolving-door* lobbyists per bank.[190]

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[188] See http://www.opensecrets.org/news/2009/01/washington-lobbying-grew-to-32.html.

[189] Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, Knopf Doubleday Publishing, 2010, pp. 192.

[190] According to WIKIPEDIA, "The revolving door is the movement of personnel between roles as legislators and regulators and the industries affected by the legislation and regulation and on within lobbying companies. In some cases the roles are performed in sequence but in certain circumstances may be performed at the same time. Political analysts claim that an unhealthy relationship can develop between the private sector and government, based on the granting of reciprocated privileges to the detriment of the nation and can lead to regulatory capture." As a blatant revealing door activity, one can mention Meredith Attwell Baker, an Obama appointee for Federal Communication Commissioner, who approved the merger of Comcast and NBC Universal, and then left her position a few weeks before the end of her term to become a chief lobbyist for Comcast. Ironically, On 21 January 2009, the day after he took office, US President Barack Obama signed two executive orders and three presidential memoranda (see http://www.whitehouse.gov/issues/ethics) to help ensure his administration would be a more open, transparent, and accountable government. These documents attempt to *rein in the influence of lobbyists, bring increased accountability to federal spending, and limit influence of special interests; they include a lobbyist gift ban and a "revolving door" ban*. In May 2009, a Recovery Act Lobbying Rules set new limits on special interest influence (see Jesse Lee (29 May 2009). "Update on Recovery Act Lobbying Rules: New Limits on Special Interest Influence"). Accordingly, while Federal law says Baker can't lobby the FCC for 2 years. But lobbying Congress is OK – and that's what she'll do. Arguments against these type of activities are abundant, "People should be outraged about this kind of blatant revolving-door activity, where one day you're supposed to be a public servant, and the next day you simply go to work advocating for these big companies," says Craig Aaron, president of the media advocacy group Free Press. However, the counter arguments are usually are made by insiders like Thomas Susman, head lobbyist for the American Bar Association and a longtime student of ethics-in-government issues, who claims in an interview with NPR, "I don't like the results of saying you can't do it," he says. "And so, therefore, I suspect I'm willing to live with public perception, you know, of cronyism, and the occasional situation where it actually proves detrimental to the public good." (See http://www.npr.org/2011/05/12/136250400/for-government-employees-revolving-door-continues?sc=emaf).

It should be noted that a law in the penal code of France governing public officials who move between the public and private sectors *requires a 3-year* wait between working in the government and taking a job in the private sector, while in Japan, the institutionalized practice of placing government bureaucrats into senior positions of industries they once regulated, known as Amakudari, has increasingly been recognized for its corrupting influence on government. In April 2007, a law to phase out Amakudari will prohibit ministries from attempting to place bureaucrats in industry in 2009. However, the law also removed a *2-year ban* that prevented retiring officials from taking jobs with companies they had official dealings with during the 5 years prior to retirement.

This includes 33 chiefs of staff, 54 staffers to the House Financial Services Committee and Senate Banking Committee (or a current member of that committee) and 28 legislative directors. Senate Banking Committee chair Christopher Dodd (D-CT) leads all current members of Congress, with five former staffers now working as big bank lobbyists. Banking Committee ranking member Richard Shelby (R-AL) and members Chuck Schumer (D-NY) and Tim Johnson (D-SD) each have four. Many of the revolving-door lobbyists were key architects of financial deregulatory legislation during their time as congressional staffers, including the Financial Services Modernization (Gramm-Leach-Bliley) Act of 1999 and the Commodity Futures Modernization Act."[191] As the result of the financial power politics various policies as well as institutional changes ensued. As Rajan suggests, "*Deregulation* has removed artificial barriers preventing entry, or competition between products, institutions, market, and jurisdiction."[192] He also points to "The process of *institutional change* has created new entities within the financial sector such as private equity firms and hedge funds, as well as new political, legal, and regulatory arrangements." These changes also are widely spread in the globalized economic system, particularly among G20 countries.

Today, policy formulations in Washington, London, or any other capitals of developed economy, are formulated by particular interests and led by thousands of lobbyists. This army does not simply reflect a swollen bureaucracy, but also represents the fundamental confusion that has intervened in the decision-making process of the modern liberal economies. This confusion, first and most, caused by disappearing between private and common interests in a sense that we have no common interest, but rather a collection of fragmented private interests that guides our societal desires and goals. Second, the important of information confirmed the aphorism of "information is power," for power lies in the global system in the mastery of information. As part of global meritocracy, professionals and lobbyists mobilized all the information necessary for the interest they represent and to present the point of view that they employed to defend.[193] Today, there are abundant instances that confirmed this observation. For example, the US Monitor Group, a consulting firm founded by a Harvard Business School, had been paid by the Libyan government millions of dollars a year to support the public image of Libya and had used very

[191] See Kevin Connor, *Big Bank Takeover: How Too-Big-To-Fail's Army of Lobbyists Has Captured Washington*, Institute for America's Future, 2010, pp. 1–2.

[192] Raghuram G. Rajan, "Has financial development made the world riskier?" *Proceeding*, August 2005, pp. 313.

[193] We would like to underline an important point here. The power of information in today world is mainly related to abounded of information and easy access to various sources of information. These, in turn, make us more prone to appearances, an expression, of one's formulated view of the world. In the information age, one with almost no effort can in flight or desire, approve or disapprove, accept or refute, blame or praise, what is not exist but appear to him/her because it meant for his/her perception. In this world, as Hannah Arendt observed, "Being and Appearing coincide."

prominent individuals and professors to do this.[194] The problem is, these individuals didn't disclose their payments by the Libyan government because they knew such revelation simply discredit their works to polish the image of Mr. colonel. Another telling case is related to Frederic Mishkin. A Columbia University economist and former Fed Governor from 2006 to 2008, Mishkin was hired by the Iceland Chamber of Commerce to examine the Iceland financial institutions, including banking system, in which he and his co-author concluded: "Financial fragility is currently not a problem, and the likelihood of a financial meltdown is low." Soon after, Iceland financial meltdown occurred. Indeed, during the financial crisis, only one Western country experienced a true collapse of its banking system: Iceland. Things got so bad that the country actually ran out of foreign currency. Even today, years later, foreign money is still scarce, and the government controls how much anyone can get. While, a wrong conclusion is almost normality in research of this sort, in the Mishkin case, the point is "he was hired to be wrong."

It must be obvious that the practice of "information for sale" striped a policy-making process from ideas and ideologies and confined such process into what stock exchange is to shareholders. Just as stock exchange, in which price is increasingly dependent on the opinion of "institutional" investor, who based their judgment on information related to a professional analysis of company balance sheet, so are policy-makers increasingly dependent and seek analytical information, to formulate and legitimize their decisions.[195]

Finally, these institutions retain power due to increase size of their market share. Indeed, the size of financial sector (including banking and insurance) as a percentage of GDP is more than double by 2007 (relative to 1970s).[196] According to European Central Bank, "The prospects for the financial sector are good. Its growth

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[194] The individuals who were engaged in the Monitor project included Francis Fukuyama, author of The End of History; Richard Perle, a prominent neocon who advised President George W Bush in the buildup to the Iraq invasion; and American academics such as Benjamin Barber, Joseph Nye and Robert Putnam (see Ed Pilkington, "US firm Monitor Group admits mistake over $3 m Gaddafi deal," *The Guardian*, (Friday 4, March 2011). The article can be accessed at http://www.guardian.co.uk/world/2011/mar/04/monitor-group-us-libya-gaddafi).

[195] While, the lobbying process is correctly considered as an extension of the right to be heard and an exercise in democracy, it can also presents fatal error in comprehending what policy should be selected, how policy should be designed to address issue (or issues) in hand. As for knowing what should be done, this mode of exercise of democracy encourages simplistic oppositions. "On any given problem, there is a dominant position in relation to which one defines oneself by taking a stand for or against. Nuances and qualifications, the *not exactly* and the *more or less correct* are discredited, because they have no didactic weight. This reveals the handiwork of the lobbyist and the professionalization of information. The enrichment that lobbying affords complicates the process before fact, and simplifies it after the fact." (see Guehenno, 2000, pp. 28). It is noteworthy that the main criticism often leveled at the global system is lack of consideration for common interest. In lobbyist circles, the public remains unrepresented, and hence its interests disregarded in design and formulation of policy, both at national and global level.

[196] Thomas Philippon, "Why Has the U.S. Financial Sector Grown So Much? The Role of Corporate Finance," *NBER Working Paper* 13405, National Bureau of Economic research, Cambridge, Mass, September 2007.

rates are expected to be above GDP growth. That means the financial sector will become even more relevant for economic performance: its share in global GDP could grow from 6 to 10% in 2020. Moreover, as early as 2010 the global financial stock is expected to exceed the $200 trillion mark, compared with around $118 trillion at present."[197] Kolko claimed, "of the world's top 200 corporation, 82 are classified as service companies. They are primarily banks and trading companies. 41% of them headquartered in Japan and 33% in the United States."[198] According to Reinhart and Rogoff, "The top employees of the five largest investment banks divided a bonus pool of over $36 billion in 2007."[199] Most financial services workers in the USA, about 50,000 people that are concentrated in New York, New Jersey, and Connecticut, make more than $200,000, said Alan Johnson, president and founder of compensation consultant Johnson Associates Inc. in New York.[200] Saunders and Cornnett found that the value of total assets of ten largest financial service firms exceeds $8 trillion in 2000.[201] According to Global Finance this value reached near $21 trillion in 2010.[202] Indeed, to describe and explain these astronomical figures we have a new *word* in the global financial repertoire, known as Financialization.[203]

These developments provided ample means for financial institutions to strengthen their economic position as well as their grip over the global economic system. However, they also made the world less safer and altering the nature of common transaction in the financial sectors around the globe and allowing broader participation and much deeper financial markets, both of which added to more widely spread of risk throughout the globalized economic system. And yet, political circles around the globe as well as international organization continued their support for the prevailed financial system. In 2004, US Federal Reserve Chairman Alan Greenspan argued, "Not only have individual financial institutions becomes less vulnerable to

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[197] Speech by Gertrude Tumpel-Gugerell, Member of the Executive Board of the ECB, Liechtenstein, 28 October 2005. The entire speech is available at: http://www.ecb.int/press/key/date/2005/html/sp051028_1.en.html.

[198] Joyce Kolko, *Restructuring the World Economy*, Pantheon Books, 1988, pp. 96.

[199] Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009, pp. 210.

[200] See http://www.bloomberg.com/apps/news?pid=20601109&sid=aB3HPM8qfcVc&pos=10&om_rid=CfA9cS&om_mid=_BLq1LFB8GnQH8n&.

[201] Saunders and Cornnett, pp. 557, Table 21.1.

[202] http://www.gfmag.com/tools/best-banks/10619-worlds-50-biggest-banks.html#axzz1EBgPATOf.

[203] Financialization may be defined as: "the increasing dominance of the finance industry in the sum total of economic activity, of financial controllers in the management of corporations, of financial assets among total assets, of marketised securities and particularly equities among financial assets, of the stock market as a market for corporate control in determining corporate strategies, and of fluctuations in the stock market as a determinant of business cycles" (see *Collected Writings of Ronald Dore,* copublished by Japan Library and Edition Synapse, 2002, pp. 182–3).

shocks from underlying risk factors, but also the financial system as a whole has become more resilient."[204] In 2007, the IMF annual report, *World Economic Outlook*, claimed, "The balance of risks to the baseline growth outlook is clearly on the downside. While the underlying fundamentals supporting growth are sound and the strong momentum in increasingly important emerging market economies is intact, downside risks emanating from the financial markets and domestic demand in the United States and Western Europe have increased."[205] However, soon after the IMF report that reveals the bright future ahead, the whole world came to abrupt realization that the emperor has no clothes.

It is certainly unconvincing to argue that both views are the result of unshaken *faith* in a market economic system philosophy or *technical error* by the Fund staffs. For years, the regulators of the global money supply ignored the advice of many including their top experts like former chief economist for the Bank for International Settlements (BIS) William White, probably because it would require them to do something unorthodox, namely embark on a fundamental change in direction.

It is also hard to subscribe to views that leave the reader with more questions than answers. For instance, the "this time is different" syndrome rational put forward to Reinhart and Rogoff while provided an extremely rich quantitative analysis with immense pool of data, argues that any well-informed person, including policy makers and politicians, should have seen the 2008 crisis. The essence of the book is that while financial crises come in different varieties, they are not born of mysterious events, but frequently occurring events that can be spotted and even controlled if politicians and regulators look carefully at the signs (or know what to look for). This conclusion begs further questions like; why policy-makers and politicians didn't consider the signs that lead to crises especially since according to the authors financial crises have been around for few centuries. It seems that people almost pride themselves on not paying attention to current events. Another question is; if policy makers and politicians don't know what to look for, why are they holding such positions of power. The syndrome rational does not offer an answer. However, one plausible answer is that there is so much inbreeding within the global political circle and policy-making elites in a sense that they all have the same information sources, and hence they all use the same data sets, consider the same opinions and briefed by the same people, which eventually lead them to the same conclusion.[206]

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[204] See http://www.federalreserve.gov/boarddocs/speeches/2004/20041005/default.htm. For more information on Greenspan see http://www.nytimes.com/2008/10/09/business/economy/ 09greenspan.html?pagewanted=all.

[205] World Economic Outlook: Globalization and Inequality, IMF, October 2007, pp. xv.

[206] Based on this observation, then a joke perhaps can explain the failure to detect various financial crisis. A drunk on his way home from a bar one night realizes that he has dropped his keys. He gets down on his hands and knees and starts groping around beneath a lamppost. A policeman asks what he's doing. "I lost my keys in the park," says the drunk. "Then why are you looking for them under the lamppost?" asks the puzzled cop.

"Because," says the drunk, "that's where the light is."

"There is endless extrapolation on extrapolation on extrapolation, and for years that is what has been rewarded" said Ms. Reinhart in an interview.[207]

This book, however, offers a different view. We argue that the prevailing predicament faced by the global economic system is a result of several factors, all of which contributed to the present condition. First, the prevailing global financial system truly created peculiar conditions, in which not only increase instability of the system as a whole but also provide a magical power to financial institutions. Here, we are not talking about instability of financial system, which is measurable by the conventional approach, e.g., stress test, or perceived as financial imbalances and asset price booms that persist for some time in a financially liberalized regime (with low inflation and interest rates), before reversing abruptly in a manner that generates not only a risk of banking problems but also marked economic weakness.[208] Our view of instability of a system is based on common sense that implies quality or state of being erratic and bears attributes like lack of control or steadiness, indecisiveness in intent or purpose, etc. In this sense, we viewed the global financial system instable. Perhaps an example may clarify out notion.

In December of 1996, Alan Greenspan, was invited to speak at the American Enterprise Institute gathering hold in the Washington Hilton Hotel. His speech entitled "The Challenge of Central Banking in a Democratic Society," in which he posed

207 See www.nytimes.com/2010/07/04/business/economy/04econ.html.

208 There is a rich literature on financial instability both from theoretical discussion and practical studies. In the following we used some excerpts from an 2005 article by Davis, E. Philip (from Brunel University and National Institute of Economic and Social Research) called "Financial instability – research, assessment and policy issues"

Franklin Allen's "Modelling Financial Instability" focuses mainly on asset price bubbles and their genesis in terms of credit expansion in the presence of agency problems of financial intermediation. A close link of such episodes to financial deregulation is highlighted. When bubbles burst, they can generate instability via banking panics, the business cycle or both together.

In terms of empirical studies, Asli Demirguc-Kunt (World Bank) and Enrica Detragiache (IMF), wrote an article called "Cross-country empirical studies of systemic bank distress; a survey," in which they present updated results of their original 1998 work on empirical determination of banking crises using a *multivariate logit model* and show broad consistency of their results, despite a much wider range of crises in the sample. The authors note that the "signals" methods has been widely used in early warning systems, while probability models have been the basis of a widening of understanding of the causes of crises to include aspects such as financial liberalization, bank ownership and deposit insurance.

Finally, Claudio Borio from Bank of International Settlement (BIS) makes a transition from empirical work to analysis and assessment in "Monetary and financial stability: so close and yet so far?" He starts from the paradox that despite the achievement of monetary stability in the past 20 years financial stability has increased. Instability has typically been linked to financial imbalances and asset price booms that persist for some time in a financially liberalized regime with low inflation and interest rates, before reversing abruptly in a manner that generates not only a risk of banking problems but also marked economic weakness. In this context, he shows that a signals/indicator approach based on gaps between credit and asset prices and their longer-term trends can indeed provide an early warning of financial instability in a majority of cases, as well as having predictive power over inflation and the output gap. Claudio maintains that simultaneous achievement of monetary and financial stability will require a more macro-prudential focus of regulatory policy, as well as willingness of monetary policy makers to lean against developing imbalances.

a rhetorical question: "But how do we know when *irrational exuberance* has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?"[209] He added that "We as central bankers need not be concerned if a collapsing financial asset bubble does not threaten to impair the real economy, its production, jobs and price stability." Short after, according to Shiller, stock markets around the globe went into anxiety mood. In Japan, which was open as he gave this speech, "the Nikkei index dropped 3.2%; in Hong Kong, the Hang Seng dropped 2.9%; and in Germany, the DAX dropped 4%. In London, the FT-SE 100 was down 4% at one point during the day, and in the United Sates, the next morning. The Dow Jones Industrial Average was down 2.3% near the beginning of trading."[210] It has been said that the striking reaction of the markets all over the world was in respond to Greenspan's question, which he casually posed in the middle of a black-tie dinner gathering.

An argument can be formed to explain these reactions, which points to tendency that markets act in accordance with Greenspan's sentiment because he is one of the major global policy-makers who hinted at "collapsing financial asset bubble." If this observation is valid, then obedience to the opinions of policy makers means to uphold the authority of those who make decisions about what the market should be, and how it should operates. To uphold this authority also is to aid in maintaining aspect of the distribution of power to make decision for free market system. In this respect, however, the free enterprise system seizes to exist!

However, assuming that the global economic system is based on the free enterprise economic model, we linked these erratic reactions to public perception of financial markets around the globe. Any institution that reacts simultaneously to a rhetorical statement or a hypothetical question clearly suffers from lack of balance that either caused by widely hold expectation that the system is extremely vulnerable, and hence inclined to fail, or the mindset of participants is unsure of the present success. Either case reminded us of the idiom, "easy come and easy go," which implies that money or other material gains that come without much effort tend to vanish as easily.

Second, the prevailing global trend created condition in which financial institutions are able to create wealth as easily as emission of paper money. For instance, derivative instruments are so called because they drive their value as a financial instrument from something outside the instrument itself.[211] These instruments have

[209] Italic is not in the original text.

[210] Robert J. Shiller, 2 edition, *Irrational Exuberance*, Crown Business, 2006, pp. 1.

[211] For example, "a call option to purchase an exchange-trade stock would qualify as a derivative instrument. The value of the call option can only be determined by the market price of the related stock. For example, a call option allows the holder to purchase 1,000 shares of stock as $50 per share, but no determination can be made as to the value of the call option until the stock price is determine." (see O. Ray, CPA, PhD Whittington and Patrick R., CPA, PhD Delaney, *Wiley CPA Exam Review 2008: Financial Accounting and Reporting*, Wiley, John and Sons, 2007, pp. 693). If the market value of the stock is determined around, let say, $58 per share, the holder of stocks make $8 per share out of thin air. Of course, the opposite is also valid, however, the point is that possibility of profit out of nothing is truly brilliant and economically destructive.

no intrinsic values unless they are hedged to something of value. In short, they call derivatives because their values are drive from something else. Financial institutions are also allowed to conceal various transactions from their balance sheet, and hence defy one of the main principles of bookkeeping. However, the excitement of creating wealth out of tin air overwhelmed these institutions to the extent that they "tumble out of a window in a moment of irrational exuberance."[212]

Third, despite mounting evidence that global financial system is exposed to extreme uncertain speculations[213] and things were going wrong, all major financial institutions clung to the notion that "things would be just fine."[214] This is partly due to the fact that their interests lied in that outcome. As Rajan observed, "The problem was not that no one warned about the danger; it was that those who benefited from an over heated economy – which included a lot of people – had little incentive to listen."[215]

More importantly, however, as a result of past several decades of financial crises in various countries financial institutions gained valuable lesson, that is, a financial meltdown almost invariably leads to sharp declines in tax revenues, and hence real government debt rises. To remedy this situation the natural impulse of government,

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[212] Amanda Cross, *A Trap for Fools*, Trafalgar Square, 1993, pp. 137.

[213] Generally, the name given to financial uncertainty is risk. Moreover, "Economists differentiate gambling and speculation on the ground that gambling involves the deliberate creation of new risk for the sake of diversion while speculation involves the assumption of the inevitable risks of the capitalist process. In other word, when a gambler places a bet on a horse he is creating a risk, while the speculator who buys a share is simply involved in the transfer of an existing risk." (See Edward Chancellor, *Devil Take the Hindmost: A History of Financial Speculations*, Plume, 2000, pp. xii–xiii).

[214] In addition to historical cases, there are many scholars, academicians and economists who confirmed this conclusion. First among them is Raghuram Rajan of the University of Chicago, whose book "Fault Lines" argues that rising inequality led governments to facilitate credit growth, contributing to the crisis. Robert Shiller of Yale University has long warned of the dangers of *irrational exuberance*, and urges colleagues to consider "animal spirits" in assessing economic fluctuations. Kenneth Rogoff's work on debt bubbles with Carmen Reinhart placed the crisis in an 800-year continuum of borrowing and collapse: his papers have earned the most academic citations of the table-toppers in our poll. Edward Chaceller book on history of financial speculation is thought provoking and educational. Barry Eichengreen has written excellent works on the history of the gold standard and the danger of fixed-exchange-rate regimes. Nouriel Roubini earned the nickname "Dr Doom" for warning of an impending global crash. Finally Mark Gertler and Ben Bernanke presented a theoretical model detailing how imperfection in the financial market (due to asymmetric information between lenders and borrower can result in an exaggeration of economic downturns (see Ben Bernanke and Mark Gertler, 2000. "Monetary Policy and Asset Price Volatility," *NBER* Working Papers no. 7559). In their model, a decrease in wealth (as a result of adverse productivity shock) forced firms to scale back their investment plan. Firms are forced to scale back on investment because, as their retained earnings fall, they must finance a large share of their investment via more expensive external financing rather than by means of relatively inexpensive internal financing. "Recession cause a loss in collateral that is then amplified through the financial system." (see Reinhart and Rogoff, 2009, pp. 146)).

[215] Raghuram G. Rajan, 2010, pp. 1.

when face a financial crisis, is to bailout trouble institutions. Indeed, the bailing out approach has been a common practiced policy in face of financial crises since the banking crisis of 1977 in Spain.[216] Therefore, financial institutions around the globe were give concrete assurance that no matter how they structure their asset portfolios and/or how risky their conducts may be, they and their interests will be protected. Without a doubt, governmental pledge not only encourages financial institutions to engage in more *speculative behavior* but also renders an excellent incentive for these institutions to evade consequences and responsibilities for their actions. Economists described this situation as moral hazard.[217] Perhaps, that is why after each crisis, the financial markets invariably shrug off past follies and losses to confront the future with bright optimism and fresh credulity to the extent that rational markets descent into dementia.

Finally, submissiveness of politicians as well as policy-makers, especially among G20 economies, towards financial institutions illustrated what it means when a government as an institution failed. John B. Taylor, former US undersecretary of treasury for foreign affairs, hinted that the crisis was partly due to the government permissiveness and ad hoc support for credit providers.[218] For one thing, the laws governing markets are framed and enforced by states, and hence states failure to framed and enforced laws that tamed deviant behaviors, e.g., speculations, in markets is usually due to politicians endorsement of the status quo – taken action is particularly difficult if there is no intend to change the status quo.[219] In this regard, Chancellor observed, “On numerous occasions we find politicians stimulating speculation mania for their own gain.”[220] Alfred Marshall reaffirmed this sentiment when he wrote, “Public opinion and private morality have driven home the maxim that if

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[216] Reinhart and Rogoff, 2009, table 10.9, pp. 164.

[217] Economist Mark Zandi of Moody’s Analytics described moral hazard as a root cause of the subprime mortgage crisis. He wrote: “… the risks inherent in mortgage lending became so widely dispersed that no one was forced to worry about the quality of any single loan. As shaky mortgages were combined, diluting any problems into a larger pool, the incentive for responsibility was undermined. At every point in the financial system, there was a belief that someone – someone else – would catch mistakes and preserve the integrity of the process. The mortgage lender counted on the wall Street investment bankers, who counted on the regulator or the rating analyst, who assumed global investor were doing their own due diligence. As the process went badly awry, everybody assumed someone else was in control. No one was.” (see Mark Zandi, *Financial Shock*. FT Press, 2009, pp. 2–3).

He also wrote: “Finance companies weren’t subject to the same regulatory oversight as banks. Taxpayers weren’t on the hook if they went belly up [pre-crisis], only their shareholders and other creditors were. Finance companies thus had little to discourage them from growing as aggressively as possible, even if that meant lowering or winking at traditional lending standards.” (See

[218] John B. Taylor, *Getting Off Track: How Government Actions and Intervention Caused, Prolong, and Worsened the Financial Crisis*, Hoover Institute Press, 2009.

[219] As an example of such status quo one can underlined the widespread and sustained surge of capital flows, in which ING-Barings called it *the financial silk road* (see *The Financial Silk Road: A Fifth Wave of Global Money: Cross Border Equity Flows*, ING-Barings, New York, 1995, vol. 1).

[220] Edward Chancellor, 2000, pp. xiv.

a statesman bases stock exchange speculation on his policy, he will soon base his policy on his speculation."[221] This take us to another but related predicament in which policy-makers commonly mixed the private sector's objectives with the government's objectives, and hence all too often policies were formulated and designed without taking the private-government distinction into account. Of course, taken into consideration such distinction does not implies that policy-makers favor one group over the other but rather it intends to clarify the policy objective underlined what issue needs to be address first.[222]

The affects that these factors have on financial institution have magnified their inclinations and behaviors to the extent that Greenspan's notion of irrational exuberance is perfectly plausible outcome given the circumstances. According to Shiller, irrational exuberance "is the psychological basis of a speculative bubble."[223] If we start from here, then one can easily observed that financial institutions' operation and conduct, especially in the prevailing environment, are so divorce from the prescribed textbook scenario that described financial markets are efficient in a sense that share prices reflect intrinsic values, and that speculators are simply rational agent intent on optimizing their wealth. In the world of efficient market, as Chancellor explained, "there are no animal spirit, no crowd instinct, no emotions of greed or fear, no trend-following speculators, and no 'irrational' speculative bubbles."[224]

[221] Cited by Edward Chancellor, 2000, pp. xiv.

[222] Robert Reich, the former secretary of labor under President Clinton first term, underlined this point elegantly when he stated, "What is truly remarkable is what Congress and the administration have shown no interest in doing. Large number of American have lost their homes to bank foreclosure or are in danger of doing so. Yet American bankruptcy law does not allow homeowners to declare bankruptcy and have their mortgages reorganized. If it did, homeowners would have more bargaining power to renegotiate with banks. But neither Congress nor the administration has pushed to change the bankruptcy laws. Wall Street opposes such change and was instrumental in narrowing the scope of personal bankruptcy in the first place." (see Robert Reich, "Why Obama must take on Wall Street," *Financial Times*, January 12, 2010). In respond, one may claimed that banks hold the heart bit of the economy ("too big to fail" rational) and therefore to help people, we need to help bank. However, such argument is weak on several fronts. First, banks should not hold such significant position since their function is clearly defined in economic theory as monetary intermediaries. Second, assuming banks are too big to be failed, the bailout policy is misguided and does not address the more important issues. For instance, in addressing the recent controversies of improper foreclosures during a speech last November, Fed governor Sarah Bloom Raskin said procedural flaws like *robo-signing* and other efforts that cut corners are "part of a deeper, systemic problem." She added that she was "gravely concerned." The complex challenges faced by the loan servicing industry right now are emblematic of the problems that emerge in any industry when incentives are fundamentally misaligned, and when the race for short-term profit overwhelms sustainable, long-term goals and practices," Raskin said. "I believe that serious and sustained reform is needed to address the larger problems in mortgage servicing." (see http://www.huffingtonpost.com/2011/02/16/occ-settlement-foreclosure-investigation_n_824357.html). Finally, As Axel A. Weber, an European Central Bank (E.C.B) policy maker and the head of Germany's Bundesbank, observed, "if financial institution appears too big to fail, they are two big to exist."

[223] Robert J. Shiller, 2 edition, *Irrational Exuberance*, Crown Business, 2006, pp. 2.

[224] Ibid., pp. xiii.

Conversely, it has been known for sometimes know that financial market operates on the basis of *crowd psychology* rather than textbook rationality.[225] This observation does not refute the notion of efficiency, however, it applies the concept in the different domain, namely speculator behavior. As Pepper and Oliver explained, "Speculators are remarkably efficient at detecting the game in town' making money. When monetary forces are powerful, 'following the trend' (buying when the market is rising or selling when the market is falling) is profitable. People join in, and the heard instinct prevails. A crown forms, and patterns in chart follow."[226] The significant of crowd psychology is related to the fact that people in a crowd act differently from the way they would act if they were alone. The behavior of a crowd is different from the sum of the behavior of individuals if they are acting in isolation, as described by textbook scenario.[227]

[225] According to Edward Glaeser, "Over the past two decades, predictions that came from the convenient assumptions of powerfully rational cognition and simple preferences have been challenged by an increasingly large number of facts. The unifying thread of much of behavioral economics is situationalism – the idea that decisions are made based on very local influences, not long-run well-being (Ross and Nisbett, 1991). Prospect theory (Kahneman and Tversky, 1979) tells us that people put enormous weight even when those reference points are quite arbitrary and ephemeral. Mental accounting (Thaler, 1985) tells us that people often make decisions ignoring events and consequences outside of a particular narrow domain. Hyperbolic discounters place an exceptional weight on the present and cue theory emphasizes ephemeral situational forces. People display negative altruism in ultimatum games based on a modest, situational cue." (see Edward L. Glaeser, "Psychology and the Market," *NBER Working Paper* 10203, 2003, pp. 2). Situationalism also includes two other theories, namely, *property theory* and *loss aversion*. As Genesove and Mayer observed, "Prospect theory argues, in part, that individuals make financial decisions relative to some reference point, suggesting that otherwise identical persons might act differently based on the price they paid for an asset. To explain loss aversion, also known as the disposition effect, prospect theory suggests that an individual's value function is concave in gains but convex in losses, and much more sensitive to losses than to equivalent-sized gains." (see David Genesove and Christopher Mayer, "Loss Aversion and Seller Behavior: Evidence From The Housing Market," NBER Working paper 8143, 2001.). Interestingly, in the same paper, Genesove and Mayer argued that "loss aversion helps explain seller behavior in the residential real estate market. When house prices fall after a boom, as in Boston, many units have a market value below what the current owner paid for them. Owners who are averse to losses will have an incentive to attenuate that loss by deciding upon a reservation price that exceeds the level they would set in the absence of a loss, and so set a higher asking price, spend a longer time on the market and receive a higher transaction price upon a sale" (see Ibid.).

[226] Gordon Pepper and Michael Oliver, *The Liquidity Theory of Asset Prices*, John Wiley and Sons, 2006, pp. 6.

[227] Conventional economic analysis based on individuals acting in isolation, away from all possible interferences that may occurs in a human community and life, and hence individuals acting rationally – the utility function is optimized given perceived opportunities. Following this perception, the textbook necdote perceived that total market behavior is no more than the sum of decision by rational individuals. In this respect, "the market behaves as a coherent whole. It develops a life of its own." (See Gordon Pepper and Michael Oliver, 2006, pp. 82).

Indeed, in the world operates according to crowd behavior, like financial world, expectations are form as a result of a crowd mindset.[228] In this kind of world, according to Burton Malkiel, "there is a sucker born every minute – and he exist to buy your investment at a higher price than you paid for. Any price will do as long as others may be willing to pay more. There is no reason, only mass psychology… It is perfectly all right to pay three times what something is worth as long as later on you can find some innocent to pay five times what it's worth."[229] The Malkeil simple but clear explanation provides excellent description of the impact of crowd psychology as well as a sufficient account as to why rising prices can lead to expectation of further rises and vies versa, falling prices lead to expectation of further falls. Keynes also described the optimal strategy to select stocks for future earning prospect by emphasizing on crow psychology – the smart speculator/investor never chose stocks based on personal preferences but rather fancy those that are likely to be value by others.[230]

[228] For skeptical readers we suggest a friendly chat with those individuals involved in past ponzi schemes, and in particular the Bernie Madoff ponzi scheme, like Senator Frank Lautenberg, owners of the NY Mets and the Philadelphia Eagles, real-estate magnate Mortimer Zuckerman and the foundation of Nobel laureate Elie Wiese, and Steven Spielberg's charities. More importantly, according to Financial Times, HSBC, one of the ten largest global bank "has emerged as one the largest victims of Bernard Madoff's alleged fraud with potential exposure of about $1bn to the investment manager's collapsed venture…HSBC's exposure stemmed from loans it provided to institutional clients, mainly hedge funds of funds, that wanted to invest with Mr Madoff. HSBC's direct exposure is believed to be about $1bn in loans provided to clients who invested some $500 m of their own funds in Mr Madoff's venture. Under the typical terms of these deals, if the US authorities recover any funds from Mr Madoff, HSBC will be paid first, with its clients suffering the first tranche of losses."

[229] Burton G. Malkiel, *A Random Walk Down Wall Street*, W. W. Norton, 1996, pp. 32.

[230] According to Malkeil, "Keynes described the playing of the stock market in terms readily understandable for his fellow Englishmen; It is analogous to entering a newspaper beauty-judging contest in which you have to select the six prettiest faces out of a hundred photographs, with the prize going to the person whose selections most nearly conform to those of the group as a whole. *The smart player recognizes that personal criteria of beuty are irrelevant in determining the contest winner. A better strategy is to select those faces the other players are likely to fancy*. This logic tends to snowball. After all, the other participants are likely to play the game with at least as keen a perception. Thus, the optimal strategy is not to pick those faces the player thinks are prettiest, or those the other players are likely to fancy, but rather to predict what the average opinion is likely to be about what the average opinion will be" Ibid, pp, 31. Italic is not in original text. The reader should note that in the domain of pure theoretical economics such as the game theory paradigm the outcome can be different. For instance, in so called Expectation equilibrium, which introduced first by 1994 Nobel Prize winner John C. Harsanyi suggests, "When everyone's playing his or her best move *conditional on expectations* of everyone else's best move, then no-one's going to want to move. This idea builds on the forgoing idea of thinking forward and reasoning backward, but now makes it conditional – not on the assumption of perfect rationality on the part of all players – but on one's *perceptions* of what the other player is likely to do. One way to think about this is by considering what a famous nineteenth century German General, Baron Von Cluasewitz, called the "Fog of Battle." To read more on this topic see Philippe Jehiel, "Analogy-based expectation equilibrium," *Journal of Economic Theory*, vol. 123, 2005, pp. 81–104.

The crowd behavior influence on financial markets has been observed since the first financial crisis occurred in 1593, known as the tulip-bulb craze.[231] The wild speculation of 1593 triggered by nonfatal virus (called mosaic) infected tulip bulbs. The infected tulips petals had developed contrasting colored strips in which valued by people, and hence become subject to speculation attack – the more valuable (expensive) the bulbs become, the more people viewed them as subject of speculation. As a result, bulbs prices reached astronomical level to the extent that "The riches of Europe would be concentrated on the shore of the Zuyder Zee, and poverty banished from the favoured clime of Holland. Nobles, citizens, farmers, mechanics, seamen, footmen, maid-servants, even chimney sweeps and old clothes-women dabbled in tulips. People of all grades convert their property into cash, and invest it in flowers."[232] However, like all financial exuberance proceeds it, the market crashed in 1637, bankrupting many and the era came to be known as "Tulipmania" or "Tulipomania." Perhaps, to sum up the issue of speculation, we can learn from one of the greatest American writer, Mark Twain, who advised us, "October. This is one of the peculiar dangerous months to speculate in stocks in. The other are July, January, September, April, November, May, March, June, December, and February. – *p*udd'nhead Wilson calendar."[233]

[231] In reviewing the literature on the topic, we have found the rich tradition that goes back as far as 1841. Charles Mackay the author of *Extraordinary Popular Delusion and Madness of Crowd* (first published in 1841) perhaps provide the first account of crowd psychology when he wrote, "Money, again, has often been a cause of the delusion of multitudes. Sober nations have all at once become desperate gamblers, and risked almost their existence upon the turn of a piece of paper… Men, it has been well said, think in herds; it will be seen that they go mad in heard, while they only recover their senses slowly, and one by one." (See Charles Mackay, *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*, FQ Books, 2010, pp. 9). In the *Psychology of the Stock Market*, written by G.C. Selden and published first in 1912, but could have been published yesterday, Selden begins by observing that "Human impulses lead to speculative disasters." (see G. C. Selden, *Psychology of the Stock Market*, Fraser Publishing Co, 1995, pp. 1). In *The Money Game*, Adam Smith takes a note of Harvard Economists Thomas Schelling, who described the stock market as the greatest gambling enterprise in the United Stated, and respond, "in no sense is the stock market a great gambling enterprise like a lottery. But it is an exercise is mass psychology, in trying to guess better than the crown how the crowd will behave." (See Adam Smith, 8th edition, *The Money Game*, Vintage, 1976, pp. 18). These books are far more valuable books today precisely because it was written so long ago. In our opinion, these books would allow the reader to trace the contours of what was taken place in the nineteenth century, first decade of the twentieth century, and see that the same factors still dominate in the twenty-first, it becomes far more readily apparent what is truly vital (in terms of understanding financial institutions) *versus* what is not. Perhaps this is the main reason why books like these tend to last, while the vast majority of high-powered academic theories get scrapped.

[232] Charles Mackay, *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*, FQ Books, 2010, pp. 65. This book first published in 1841.

[233] Mark Twain, Pudd'nhead Wilson, Chatto and Windus, Piccadilly, London, 1894, pp. 130.

The important of financial institutions to the global economic system is also significant factor, which highlights their power. Renato Ruggiero said it best when he explained to WTO members, "The global economy is only as strong as the global financial system which underpins it."[234] Gilpin drive to similar notion when he says, that "international finance is a major force in integrating the world economy."[235] However, we think the role of financial sector as the main catalyst for driving the world into a single economic system in more than that in a sense that such system could only be achieved by integrating various national financial systems into one harmonized global financial system that operates and function according to a uniform guideline and standard. In this respect, the global coordinating agencies like IMF and the World Bank can play a vital role in a sense that they can managed the whole integration affairs by speak for the world to the world. Rajan suggests that these agencies "In addition to trying to persuade finance ministers and head of state [to integrate into global financial system] they should go directly to the public, including political parties, nongovernmental organizations, and influential personalities in each country and explain their position. They need to become much more sophisticated about using Web-enable network to reach the connected citizen and find ways to enter school and university class-room, where students can be most receptive to ideas about global citizenship."[236] He further reasoned that action as such are extremely important because "The public has a longer-term horizon that the government in power and typically more idealism and concern for the global good."[237] In this respect, a single standard financial system that operates at global level not only established its' important, but it also plays a major role in political development around the globe.

The ability to excise power by these institutions has eventually created an environment that shapes the global system, or as John Kenneth Galbraith observed, "In Financial Sector we Trust."[238] Since the late 1960s, the world economy has danced more and more frantically to a tune played by the financial sector. Haldane's chart makes this point somewhat obvious (see Fig. 2.1).

This observation has also been confirmed by various sources and reports. However, here we only present two such studies that were prepared by insiders, men that are well connected to the financial world. First, is the report called "Banking on

[234] WTO Press release, *Address to the to the XII meeting of the common market council at the MERCOSUR Heads of State Summit in Asunción, Paraguay*, 19 June, 1997. Renato Ruggiero is the former first director-general (1995–1999) of the World Trade Organization (WTO) in addition to Chairman of Citigroup in Switzerland, Vice Chairman of Citigroup's European Investment Bank, Chairman of the International Advisory Board of UniCredit, and former Italy's foreign minister in Silvio Berlusconi's government.

[235] R. Gilpin, *The Political Economy of International Relations* (1987), p. 206.

[236] Raghuram Rajan, 2010, pp. 213–14.

[237] Ibid., pp. 214.

[238] We made snall modification of the phrase to fit the context. The actual phrase was "In Goldman Sachs we Trust," see J. K., Galbraith, *The Great Crash 1929*, Penguin, 1954.

Fig. 2.1 UK Banking Sector assets as % of GDP

the State" [239] by Andrew Haldane and Piergiorgio Alessandri, which are making waves in policy-makers and academic circles. Haldane, Executive Director for Financial Stability at the Bank of England, is widely regarded as both a technical expert and as someone who can communicate his points effectively to policymakers. According to their report, the *boom-bust-bailout cycle* is nothing more than a *doom scenario* in a sense that major financial institutions and banks have an incentive to take excessive risk, since they bailed out is most likely, and hence the conditions for the next crisis are created. The overall conclusion of the report can be summarized as follow: unless and until the political power of major financial institutions and largest banks is broken, the world will continue to struggle (or, rather, we are looping around the same doom).

The second study is the book labeled *13 Bankers,*[240] which is written by former Chief Economist of the International Monetary Fund, Simon Johnson, and former McKinsey & Co. consultant, James Kwak. The book describes the rise of concentrated financial power and the threat it poses to our economic well being. According to the authors, over the past 3 decades, a handful of banks used their power and prestige to reshape the political landscape. By the late 1990s, the conventional wisdom in Washington was that "what was good for Wall Street was good for America."

[239] A. G., Haldane and P. Alessandri P, *Banking on the State*, London: Bank of England, 2009.

[240] Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, Knopf Doubleday Publishing, 2010.

In particular, Johnson has been quite outright about the power of financial institutions and banks to the extent that a year after the crisis hit the main street he warned that the US economic recovery would fail unless the "financial oligarchy" is dismantle.[241]

Additionally, the power of major financial institutions has already ratified by major industrialized economies' bail out policies, which intended to ease the pain inflicted by the 2008 financial crisis, instead of addressing the underlying cause.[242] In fact, the crisis can be served as the reveling indictor of financial sectors' power. At each step of the way since crisis began, the major financial institutions and banks were seem to drive the policy objective to the extent that even the Governor of the Bank of England, Mervyn King, has stated, "The sheer scale of support to the banking sector is breathtaking. In the UK, in the form of direct or guaranteed loans and equity investment, it is not far short of a trillion (that is, one thousand billion) pounds, close to two-thirds of the annual output of the entire economy. To paraphrase a great wartime leader, never in the field of financial endeavor has so much money been owed by so few to so many. And, one might add, so far with little real reform."

More importantly, a simple comparison between the precrisis and post-crisis periods clearly illustrates the power of the "coordinator" agencies such as the World Bank and IMF in shaping the overall economic policies and objectives around the globe. As the Economists observed, "BEFORE the global economic crisis, the IMF's slide into irrelevance seemed assured. Now, it is back at the frontline of gargantuan bail-out packages, wrangling over government spending and tax reform, and attempts to stop sovereign defaults further disturbing the jittery global financial system."[243] However, the involvements of these agencies were not limited to the 2008 crisis. For instance, the sovereign debt[244] crisis in early 2010 amplified the role of agencies (and inability of nation-states to control their economic affairs) to ease

[241] Simon Johnson, The Quiet Coup, The Atlantic Online May 2009. In the interview with Bill Moyers, Simon elaborated on his view. The following is an excerpt of the interview. BILL MOYERS: So you're not talking about nationalization, are you?

Simon Johnson. I'm talking about a scaled up FDIC intervention. I think we need the FDIC to be empowered. And to have the political support necessary to get this job done.

Bill Moyers. Splitting this one powerful interest group into competing factions, and taking them on one by one.

Simon Johnson. That is classic oligarchy breaking strategy. Now I do admit that once you've done that, you have to worry about the new oligarchs. That's why you're breaking up the banks. You don't want to just change the owners of banks that are too big to fail, because they'll be coming around in 5 years for another handout.

[242] Which is politics. Unless and until we break the political power of our largest banks, broadly construed, the world is going nowhere (or, rather, we are looping around the same doom).

[243] See *The Russian default: Stumbling towards infinity*, the Economists, Nov 25th 2010.

[244] Or another way of saying the same thing is sovereign credit risk – ability of sovereign state to meet its promised payments to creditors (those investors in sovereign bonds, those issued by governments).

the fear of government default and calm down the global financial circle through formulations of yet another rescue package for Europe Union members, particularly Greece and Ireland (while Italy, Spain, Portugal, and Belgium are allegedly waiting in the wings). The sovereign debt issue portrayed as a crisis of confidence, particularly in term of risk insurance on credit default swaps,[245] among EU members. To meet the creditors demand and stabilized the financial situation, EU finance ministers and IMF approved rescue packages, on condition of severe austerity measures, in which the Greek government is expected to received 100 and 120 billion euros (133 and 160 billion dollars) and about 85 billion euros (112 billion dollars) will go to the Irish government.

However, once the dust of anxiety settle down and debts are collected, it should become obvious that these rescue package, like the previous ones, do not intend to address the overall causes of problems but rather aimed to assist financial institutions and banks to collect payments promised to them by national governments, and hence as the phrase goes "restore the confidence in the financial market."[246] For one thing, the average interest rates charged on these rescue packages are well above the prevailing market rate. For instance, for the Irish package, EU and IMF will charge an average of 5.8%,[247] in which the EU is contributing 45 billion dollars and the International Monetary Fund (IMF) 22.5 billion dollar (and Ireland will contribute 17.5 billion euros to the fund for the banks from its cash reserves and National Pension Reserve Fund). The economic rational to attached the notion of "rescue" to these type of packages commonly implies "saving an economy from default" instead

[245] Credit default swaps (CDS) are financial instruments intended to provide risk insurance to banks and bondholders in case a particular bond or security goes into default (when there is not enough revenue behind the loan to meet the promised payments). Their purpose is to make it easier for banks to issue complex debt securities by reducing the risk to purchasers. For instance as of 2009, it costs about 2.6% of the principal each year for investors to insure Greek government bonds against default, according to CMA DataVision. By the way, these CDS are another brilliant invention of Wall Street in the late 1990s. For more information see Times Topics, "Credit Default Swaps," *The New York Times*. Retrieved on May 11, 2009.

[246] Apparently, no one in policy-making and financial institution circles, or global epistemic communities exposed to the Hyman Minsky concept of the instability of stability. As a student of Joseph Schumpeter, the noted Austrian economist who documented capitalism's ceaseless process of "creative destruction," Minsky spent more time thinking about destruction than creation. In doing so, he formulated an intriguing theory: not only was capitalism prone to collapse, he argued, it was precisely its periods of economic stability that would set the stage for monumental crises. Minsky called his idea the "Financial Instability Hypothesis." In the wake of a depression, he noted, financial institutions are extraordinarily conservative, as are businesses. With the borrowers and the lenders who fuel the economy all steering clear of high-risk deals, things go smoothly: loans are almost always paid on time, businesses generally succeed, and everyone does well. That success, however, inevitably encourages borrowers and lenders to take on more risk in the reasonable hope of making more money. As Minsky observed, "Success breeds a disregard of the possibility of failure."

[247] Still there are report the interest charge may be even larger than this amount. For instance, Ireland's RTE broadcaster reported that the country may have to pay a rate as high as 6.7% on some of the money.

of "pushing an economy further into default," which is certainly a possible scenario for these economies.[248] It makes no economic sense to expect a indebt government to repay loans that charges well above an average market interest rates as a means to get out of insolvency.[249]

Moreover, the circumstances under which these European economies endure payment defaults were created partly by the global *boom-bust-cycle*, e.g., low/high interest rates, as well as EU membership restrictions.[250] For instance, as part of these restrictions an EU member is deprived of using devaluation as a monetary instrument to meet her external financial obligations. More importantly, as a direct result of globalization of finance (international markets access to national economies) states cannot raise financial capital according to their own preferences[251] and usually engage in what is known as "open market operation" in which state's debt place in various financial markets, and hence adjustment to meet the promised payment is dictated rather than negotiated. As Nouriel Roubini observed, "In Greece or Spain or Portugal, the bond markets are forcing an adjustment. In spite of the recession, the markets are telling them to either straighten out their problems or go bankrupt."[252] It should be noted that as of the summer of 2011, we are genuinely convinced that chances of Greece not defaulting is really slime, regardless of the second round of bail-out, unless some kind of a fiscal consolidation, which means all of affairs that related to budget are government by some central consul, occurs. The arithmetic is such that default is inevitable since Greece faces the interest rate (on its 2 years loans) that has reached unprecedented 30%.

[248] The post 2008 US FED policy provide an excellent case. As part of the economic bailout, the U.S. FED provided a discount rate well below 1%, while the banks in U.S are charging the public over 5% (on average). And yet, some major U.S. bank still holding back and not offering wide range of financial assistances.

[249] Even if the underlying aim for such high charged interest rate is a punitive measurement since such "stick" is usually accompany with "carrot," which in this is absent.

[250] For instance, all EU member states required to relinquished their national currencies and adopt the single currency. By doing so states not only subordinate their monetary policy to the union central authority, but also forgo their sovereignty and make themselves vulnerable in time of economic stress, the process in which we are currently witness.

[251] It is also important to remember, as Edward Harrison reminds us, that "countries like the U.S. or the U.K. can just print money to meet creditor demands. After all, the only financial obligation of government in a fiat currency system is the payment of more fiat money. This is a confidence game then. Creditors will only accept more fiat money from the debtor if they believe that the money represents good relative future value (i.e. when debt repayment occurs and where value is relative to other currencies or real assets at that time)." For full article see Edward Harrison, "On The Sovereign Debt Crisis", Huffington Post.com, December 2, 2009.

[252] Nouriel Roubini, "Greece debt is only the tip of the iceberg", The Christian Science Monitor, April 29, 2010. The paper is available at: http://www.csmonitor.com/Commentary/Global-Viewpoint/2010/0429/Roubini-Greece-debt-crisis-is-only-the-tip-of-the-iceberg.

Global Governance

The globalization of economic has tilts the conventional perspective from state to markets. In this book, we concern with an emerging thinking that the world production and economic exchange driving nation-states toward "borderless world."[253] The internationalization of production and global exchange of goods and services have more direct implication for coalitions of national interests than for nation-states. The symmetry of this view indicates that there is substantial tilt away from the significant of autonomous national policy design and policymaking. This means *power relationships and processes of opinion making and decision making are increasingly located in complex and transnational settings, characterized by shifting alliances among international as well as national stakeholders instead of nation-states*.

In light of this observation, the *global governance* shifts the location of authority in the context of both integration (globalizing) and fragmentation (localizing). This is the usage pioneered by James Rosenau. He brought the notion of global governance into popular mindset, a prominence if you would, in conjunction with a terminology intended to welcome the way in which global change is an encompassing phenomenon involving relocation of authority across multiple levels and areas. Rosenau describes the process as "a pervasive tendency… in which major shifts in the location of authority and the site of control mechanism are under way on every continent, shifts that are as pronounced in economic and social systems as they are in political systems."[254]

Rosenau's works on global governance reject the common presumption, wishful thinking in his term, that "somehow our messy, tension-ridden world must be undergoing governance on a global scale marked by a modicum of coherence," the dismissal that we also subscribed to. While, he sees the emergences of global governance paralleled with the acceleration of globalization, the "inextricably linked" has to be examined, according to Roseau, in light of three sources. "One involves the need to refer to the exercise of authority to global governance inasmuch as such a structure neither exist nor hovers on the horizon. Second, the need to speak of transnational authority was intensified by the Apollo picture of the earth taken from outer space that depicted a lonely spheroid in a vast universe and thereby served to heighten a keen awareness of humankind as sharing a common life. Third, for a long time the world was described as increasingly interdependence, but not until the Cold War ended were people freed up to fully recognize that the dynamic of interdependency tended to have consequences that are global in scope."[255]

[253] See Kenichi Ohmae, *The Borderless World: Power and Strategy in the Interlinked Economy*, Harper Paperbacks; Revised edition, 1999.

[254] James N. Rosenau, *The Study of World Politics: Volume 2: Globalization and Governance*, Taylor and Francis, Inc, 2006, pp. 126.

[255] Ibid, pp. 147.

The focus here on global governance is not in any way to imply a concern with some notion of world government. Indeed, in our opinion the prospects of a world government in the foreseeable future are nil, however, and at the same time we conceive of governance as occurring on a global scale to confront worldwide predicaments, e.g., financial crises, which cannot be address by nation-states alone or by a single agency of governance. In other words, governance occurs on a global scale through institutional arrangement that encompasses the coordination of nations-states and vast array of rule and standards that intend to exercise authority preemptively in the pursuit of specific goals and "that function outside national jurisdiction." The reader should note that in term of pursuing specific goals and objectives, such institutional arrangement does resemble a *formal organization*.

While global and national mechanism differ in many respect, e.g., the extent of their control over economic affairs, both must face the similar challenges to governance. Both must deal with rapidly changing world in which goods, information, people and idea are in "continuous motion" that propels perpetual rearrangements of social, economic and political spheres. Both are challenged with the instability and disorder that at one end driven by the power, e.g., of financial institutions, and at the other end compelled by resource shortage (ranging from fiscal disarrays to rasping unemployment). Under these circumstances, it seems reasonable for an entity such as global governance "to consist of proliferating mechanism that fluctuate between bare survival and increasing institutionalization, between considerable chaos and widening degree of order."[256] In this respect, there is no center or supreme power, but only a multitude of groups (nation-states), in which all designated elements integrated in a game of *quasi-reciprocal dependencies*.[257] The diffusion of power has taken the sting out of conflict. "And like a block of granite that is being eroded into sand, the imperial [global] age is dissolving conflict into a thousand impalpable fragments."[258] Indeed, when a system, like global system, is functioning by designated sets of rules and standards, there is no time for conflict to emerge, similar to the *past-centralized mechanism*, it is dissolved in a multitude of microdecisions within the existing hierarchy structure.

Global Neighborhood

In 1994, Anthony Giddens proclaimed, "Globalization is really about the transformation of space and time. I define it as *action at distance*, and related its intensifying over recent years to the emergence of means of instantaneous global communication

[256] Ibid, pp. 127.

[257] The Greece insolvency case present an ample example of such reciprocity, in which Greece failure to lead to Europe decline in value and hence hinder economic recovery at the global level.

[258] Jean-Marie Guehenno, 2000, pp. 73.

and mass transportation."[259] However, here the Giddens' terminology intends to suggest that globalization becoming more and more a consequence of the prescribed institutional arrangements, which denies local context but promotes certain ideals. This is a process that driving nations states around the world towards the notion of "global neighborhood," and hence entails to be managed by the global entity called the global governance. In this respect, action at distance is a process, which stretches national institutional arrangements in addition to removing economic and political relationships that govern people day-to-day lives from local contexts to distance global one. David Held also noted this development when he stated, "globalization can be taken to denote the stretching and deepening of social relations and institutions across space and time such that, on the one hand, day-to-day activities and increasingly influenced by events happening on the other side of the globe, and on the other, the practices and decision of local groups or communities can have significant global reverberations."[260]

In light of these claims we began by understanding the notion of the "global neighborhood." In 1995, the Commission on Global Governance[261] published a report[262] called "Our Global Neighborhood," in which it underlined the rational and need for creation of global governance, as it observes, "The changes of the last half-century have brought the global neighborhood nearer to reality – a world in which citizens are increasingly dependent on one another and need to cooperate. Matters calling for global neighborhood action keep multiplying. What happens far away matters much more now." The report also highlights certain issues of concern, which included (1) global security; (2) managing economic interdependence; (3) promotion of larger role for international agencies, e.g., UN and IMF; and (4) strengthening the rule of law worldwide.

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259 Anthony Giddens, *Beyond Left and Right: The Future of Radical Politics*, Stanford University Press, 1994, pp. 4.

260 David Held, *Democracy and the Global Order*, Stanford University Press, 1995, pp. 20.

261 The Commission on Global Governance (CGG), was established in 1992 with the full support of the U.N. Secretary General Boutros Ghali and with the goal of strengthening global cooperation, securing global peace, achieving sustainable development and universalizing democracy. Chaired by Ingvar Carlson, the former Prime Minister of Sweden, and Shridath Ramphal, former Secretary General of the Commonwealth from Guyana, the commission is made up of 28 public figures from around the world, all of whom participated in or formally endorsed the Stockholm Initiative on Global Security and Governance. You may recognize some of the names on the commissions membership list, such as Jimmy Carter of the USA, Benazir Bhutto of Pakistan, Boutros Boutros-Ghali of Egypt, and Maurice Strong of Canada. The Commission received funding from several governments including, Canada, Denmark, India, Indonesia, the Netherlands, Norway, Sweden, and Switzerland. Funds from Japan were also made available through two United Nations trust funds. The Commission also received funds from the Arab Fund for Economic and Social Development (Kuwait) and the World Humanity Action Trust (UK), as well as from the MacArthur Foundation, the Carnegie Corporation, and the Ford Foundation (all based in the USA). Other countries also funded meetings and paid for travel costs and hotel accommodations.

262 The report can be accessed at http://www.gdrc.org/u-gov/global-neighbourhood/index.htm.

To meet these challenges the report called for new global leadership, "As the world faces the need for enlightened responses to the challenges that arise on the eve of the new century, we are concerned at the lack of leadership over a wide spectrum of human affairs. At national, regional, and international levels, within communities and in international organizations, in governments and in non-governmental bodies, the world needs credible and sustained leadership." It further explains, "This cannot be leadership confined within domestic walls. It must reach beyond country, race, religion, culture, language, and lifestyle. It must embrace a wider human constituency, be infused with a sense of caring for others, a sense of responsibility to the global neighborhood."

The foundation for global governance, according to the report is the belief that the world is now ready to accept a "global civic ethic" based on "a set of core values that can unite people of all cultural, political, religious, or philosophical backgrounds." This conviction is complemented by another belief: "that governance should be underpinned by democracy at all levels and ultimately by the rule of enforceable law."

Few years later, in 2001, The EU study on global governance proclaimed, "The EU has a clear interest in promoting global governance as a means of achieving the core of objectives of sustainable development, security, peace and equity, objectives no territorial actor can secure alone. Positive transnational cooperation is possible and the EU should show a willingness to experiment in order to improve it. The external aspects must be key in any EU deliberations on governance."[263]

In its annual Globalization and Development report published in 2002, UN Economic Commission for Latin America and the Caribbean (ECLAC) highlighted the striking "absence of a *suitable form of governance* in the contemporary world, in economic terms (as has become particularly evident in the financial sector), as well as in several other areas/sectors."[264] The report claimed that the lack of a suitable form of governance has contributed to the sharp divergence between the reality of global problems and the political processes that continue to be pursued within national and, increasingly, local frameworks.[265] An important dimension of the globalization process, but certainly not one that has been discussed at length in the general populace popular discussion, is the gradual spread of values with regard to civil and political rights as well as certain economic and social "codes-of-conduct." In fact, efforts have been put forward so that the basic objective of an international economic order, namely to conjure a "level playing field" for the efficient operation

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[263] White Paper on Governance Working Group N 5, An EU Contribution to Better Governance beyond Our Borders called Report of Working Group "Strengthening Europe's Contribution to world governance", 2001. It can be accessed at http://www.ec.europa.eu/governance/areas/group11/report_en.pdf.

[264] *Globalization and Development*, ECLAC, April 2002. The summary of the report can be accessed here: http://www.eclac.cl/cgibin/getProd.asp?xml=/publicaciones/xml/0/10030/P10030.xml&xsl=/tpl-i/p9f.xsl&base=/tpl-i/top-bottom.xsl.

[265] Ibid.

of free market forces, can be obtained.[266] (ECLAC, 2002: 26). In other words, there are certain values/ideas that are valued above others – and these have become the norm in the global market.

These sentiments as well as the role of the G20 in the global governance process were reaffirm and defined by Pascal Lamy, the Director-General of the World Trade Organization (WTO), when he defines what he intends through the concept of global governance: "For me, global governance describes the system we set up to assist human society to achieve its common objectives in a sustainable manner, that is, with equity and justice. Growing interdependence requires that our laws, our social norms and values, our mechanisms for framing human behavior be examined, debated, understood and linked together as coherently as possible. This, in my view, is the prerequisite for genuinely sustainable development in economic, social and environmental terms."[267]

To complement the above arguments we must first take a peek at the notion of global governance. In doing so, we present a brief analysis of global governance by examine it in light of two schools of thoughts in international relations,[268] realism and liberalism perspectives. Such examination should provide sufficient background for the reader to develop an understanding of the foundation on which global governance operates and function. Before we go forward, it should also be noted that although there is no shortages of appeals to the notion of global governance, and yet no generally accepted definition of the term exist.

By tracing the origin of the term governance, some argue that the conceptual shift from government to "governance" is not as progressive as it may seem.[269] Resulting in a blurring of the delineation of political responsibility, such a shift, it is argued, increases the difficultly in holding decision-makers accountable. Others argue that the meaning behind the term "governance" is, in fact, a retreat from earlier economic reform attempts to secure universal capitalistic hegemony, where globalization intensifies the need for regulation/governance at the international level.[270]

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[266] Ibid, pp. 26.

[267] See Pascal Lamy, "Global governance in the steps of William Rappard," WTO News Speech, March 15th, 2010.

[268] According to Cynthia Weber, "To try to make sense of international politics, we often turn to IR [International Relations] theory. IR theory makes organizing generalizations about international politics. IR theory is a collection of stories about the world of international politics. And in telling stories about international politics, IR theory doesn't just present what is going on in the world out there. IR theory also imposes it own vision of what the world out there looks like." (See Cynthia Weber, *International Relations Theory: A Critical Introduction*, Rutledge, 2001, pp. 2.)

[269] See Christopher Chase-Dunn, Ellen Reese, Erika Gutierrez, Rebecca Giem, Christine Petit, and Linda Kim, *Global Party Formation in World Historical Perspective*, Working Paper no.21, The Institute for Research on World-Systems, University of California, Riverside, 2006.

[270] See David Held and Mathias Koenig-Archibug, edited, *Global Governance and Public Accountability*, Blackwell, 2005. See also Slaughter, Ann-Marie, "Disaggregated Sovereignty: Towards the public accountability of global government networks," *Government and Opposition*, 39, 2, 2004, pp159–190.

Finally, there are those who believe that "…given its difficult translatability into languages other than English, it is reasonable to assume that the term global governance is culturally not neutral. Indeed, "governance" as opposed to "government" transports the very optimistic and typically Anglo-American belief that things can happily "work out" as the result of polycentric interaction, rather than always being the result of power relationships."[271] However, the consensus among skeptics is that the global governance system simply implies disaggregated sovereignty.[272]

In this book, we followed Wolfgang H. Reinicke's central proposition in which the function of governance and government can be separated from one another. In Reinicke's view, the forces of the prevailing area, e.g., economic interdependence, can (and not will) only affect operational sovereignty of a government (rather than the legal sovereignty of a state, which can be challenged only by other states), that is, "its ability to exercise sovereignty in the daily affairs of politics."[273]

In this respect, governments have been able to make domestic public policy and also be independent actors in international political affairs. Governance, on the contrary, is a social function such as the regulation of economic affairs, and is

[271] Michel, Callon, "the Sociology of an Actor-Network: The Case of Electric Vehicle" in Michel, Callon, H. Law, and A. Rip (eds.), 1986. *Mapping the Dynamic of Science and Technology, Sociology of Science in the Real World*, Houndsmills: Macmillan, pp.19–34.

[272] See, for instance, David Held and Mathias Koenig-Archibugi, edit, *Global Governance and Public Accountability*, Wiley-Blackwell; 1 edition, 2005; and Anne-Marie Slaughter, "Disaggregated Sovereignty: Towards the Public Accountability of Global Government Networks", *International Journal of Comparative Politics*, Spring 2005, Vol. 39, issue 2, pp 159–190.

[273] Wolfgang H. Reinicke, "Global Public Policy", *Foreign Affairs*, Vol. 76, no.6, Nov/Dec 1997, pp. 129. According to Reinicke, "Sovereignty has two dimensions, internal and external. The internal dimension is the relationship between the state and civil society. Following Max Weber, a government is internally sovereign if it enjoys a monopoly of the legitimate power over a range of social activities, including economic ones, within a given territory. That power is embodied in the domestic legal, administrative, and political structures that guide public policies. With respect to the economy, internal sovereignty takes effect when governments collect taxes or regulate private sector activities. The external dimension of sovereignty refers to relationships among states in the international system. These relationships are defined by the absence of a central authority. As Thomas Hobbes put it, anarchy is the rule of the international system. External economic sovereignty comes into play when, for example, countries collect tariffs and alter their exchange rates." Ibid. For a detail analysis of this subject the reader is referred to Wolfgang H. Reinicke, *Global Public Policy: Governing Without Government?* Brookings Institution Press, 1998. It should be noted that Reinicke's idea has been challenged. For instance, Anna Leander rebuff Reinicke idea when she observes, "a diffusion of authority is undermining the state capacity for legitimate violence. Globalisation creates new sources of authority both for states and those contesting states. And since state control continues to be quintessential, there is growing competition for the control over the state. The run on the state results in a portioning up (or privatisation/feudalization) of public authority by the groups or individuals struggling to control it. As political processes are controlled, or taken over, by non-state authorities, they also challenge the capacity of public authorities to preserve and use the state's monopoly of violence." (See Anna Leander, "Globalisation and the eroding state monopoly of legitimate violence", presented at the conference "The Global Constitution of Failed States" at University of Sussex, 18–20 April, 2001).

not necessarily the same as government.[274] Accordingly, "Global public policy uncouples governance from the nation-state and government."[275] Governance, according to Reinicke, need not be equated with government but can be achieved through networks of public and private groups or institutions at national, regional and international level. Therefore, the global mechanism of governance can enjoy the benefits of governmental function, e.g., inner-security of a nation, without appealing to a formal governing structure.[276] More importantly, in the globalized economic system, national independency does not exist in a sense that no nation is self-sufficient. Each nation is involved at different levels of interaction to sell what it produces, to acquire what it lacks and also to produce more efficiently in some economic sectors than its trade partners.[277]

More than ever, *prosperity* is driving force for nations.[278] However, such prosperity entails order. In the prevailing global system, in which wealth of nation grows out of the multiplication of connections, it is necessary to avoid disruption, the unexpected, the uncertain, and the uncontrolled. In short, there must be new *order* at the global level. As Porter states, "Order is provided by the interaction of a wide variety of institutional forms and practices, which involves a shift from 'command and control' regulation to control at a distance."[279]

Inevitably, ascertaining the global order demands the multilateral framework of the community of nations in a sense that public opinions and national interests are no longer accepted as a sufficient basis for unilateral action. The nation is no longer the natural framework of political discourse since as a civilization we are beginning to dream of a world government. Consequently, no system of government can be immune from the global fancy. This observation is quite recently illustrated by

[274] As Reinicke observed, "Governance, a social function crucial for the operation of any market economy, does not have to be equated with government." (Ibid, pp. 132).

[275] Ibid.

[276] Having said that we would like the remind the reader of what Hedley Bull observed, "The starting position of international relations is the existence of *states*, or independent political communities each of which possesses a government and asserts sovereignty in relation to a particular portion of the earth's surface and a particular segment of the human population." (See Hedley Bull, *The Anarchical Society*: *A Study of Order in World Politics*, Columbia University Press, 1997, pp. 8).

[277] See Jean-Paul Rodrigue, Claude Comtois, and Brian Slack, 2nd edition, *The Geography of Transportation Systems*, Routledge, 2009, Chap. 5. This book can be access at: http://people.hofstra.edu/geotrans/index.html.

[278] Without engaging in political and philosophical debate about the meaning of prosperity, in this book we are humbly submitted to the conventional wisdom that cast prosperity in economic terms – prosperity can be achieved through an increased in the gross domestic product. This view conveys sequential outcomes – higher income means increased choices, richer lives, an improved quality of life for those who benefit from them.

[279] Toney. Porter, "Global Governance Theories, Complexity, and the Post-Crisis International Financial Architecture", Paper prepared for *International Studies Association Annual Meeting*, New York, February 16, 2009.

so called the “international community”[280] when it dictates the well of the global system in Ivory Cost and Libya. By the same token, no nation, however powerful, can single-handedly assure stability of the global order because no nation has both the trust of others and the infinite means to fulfill the role of hegemonic power, like previous eras.

Conceptual Foundation of Global Governance

With these observations in mid let us move forward with our analysis of global governance in light of the common philosophy of perception (known as international relations). According to Gilpin, the idea of a *realist* theory of global governance is a contradiction in terms because “the fundamental proposition of political realism is that the international system is anarchic.”[281] Accordingly, in an environment that a legitimate authority is absent (anarchy exists)[282] international affairs are no longer meaningful and differences between international and domestic affairs would disappear, and hence, the notion of global governance becomes null and void. However, the existence of anarchy does not prevent nation-states to work together in some area and create international institutions that reflect their mutual interest(s). Moreover, in the domain of realist thinking, a state main concern is related to its national interests, and military security as the most important of these interests, and therefore other factors such as “ideas,” “values,” and “moral” commonly play a trivial role in guiding national conducts. Indeed, the significant portion of criticisms of the major realist thinkers of twenty century is based on the notion that liberal

[280] *Foreign Policy* Magazine in its September 1, 2002, issue invited nine notable thinkers, activists, journalists, and policymakers from across the ideological spectrum to survey the international community and tell the reader what they see. Does such a community truly exist? If so, who is part of it? Who isn’t? Whose values does it reflect? And perhaps most important, how does it work? How should it work? According to the issue, invoking the notion of international community is a lot easier than defining it. Nevertheless, it observed, “We are supported by the collective will of the world,” declared US President George W. Bush as he launched the war against Afghanistan’s Taliban regime in October 2001. For many people, that collective will has a name: the “international community.” This feel-good phrase evokes a benevolent, omniscient entity that makes decisions and takes action for the benefit of all countries and peoples.”

[281] Robert Gilpin, “A Realist Perspective on International Governance”, pp. 237, in Anthony McGrew and David Held (edited), *Governing Globalization: Power, Authority and Global Governance*, first edition, Blackwell Publisher, 2002.

[282] According to Gilpin, Anarchy implies “the absent of a legitimate authority to which most states are subordinate and give allegiance”, Ibid.

conviction on power of idea is misguided.[283] Finally, concern with national security, and hence power, compels realists to think of power as vital importance in international affairs to the extent that "states must be continuously attentive to changes in power relations and to the consequences of their own national interests of shifts in the international balance of power among the members of international political system."[284] Having said that, it is noteworthy that even among realists there is no clear consensus on how to define the notion of power.[285]

In contrast, the common perception of *liberalism,* as an ideology, emphasized on the important role of the individual who should be relatively unconstrained by a minimalist state – a major theme in early capitalist writing.[286] This emphasis received further boosted when essays of such *Utilitarian* as Jeremy Bentham that viewed people as rational, calculating individuals capable of deciding what was best for themselves without much government interference. It followed that liberals emphasized the positive role played by public opinion in providing guidance to state officials and producing good public policy. However, this view of the domestic policy was carried over into the international realm. Liberals recognized that was a defining characteristic of international politics. They also agreed with realists that the state of anarchy that characterized world politics contributed to suspicion and distrust among states and hence posing an obstacle to cooperation and peace. However just as it was assumed that there could be harmony of interest among individuals

[283] For instance, in 1946 Hans Morgenthau, one of the "founding fathers" of the realist school in the twentieth century, pointed out that liberal beliefs of Western democracies made them incapable of recognizing the threat of Nazism and fascism in 1930s, and hence he concluded that it was unwise to place one's faith solely in the power of ideas (See Hans Morgenthau *Scientific Man Versus Power Politics*, University of Chicago Press, 1974. See also William Scheuerman, "Was Morgenthau a Realist? Revisiting Scientific Man vs. Power Politics" Paper presented at the annual meeting of the ISA's 49th Annual Convention, Bridging Multiple Divides, Hilton San Francisco, San Francisco, CA, USA, Mar 26, 2008). In respond to these criticism, skeptics may point out that such neglect is trivial, at best, when one looks at the 1930s as a whole in a sense that liberal did recognized the rise of Third Reich, however, they realized the attractiveness of power of economic liberalism overcome political liberal rhetoric. For instance, one can points to the warm and friendly relation between capitalist industrialist Henry Ford with Nazis Germany well into the World War II and later on with Stalinist Soviet Union during the Post-War.

[284] Gilpin, 2002, pp. 238.

[285] According to Paul R. Viotti and Mark V. Kauppi, "Some realists understand power to be the sum of military, economic, technological, diplomatic, and other *capabilities* at the disposal of the state. Others see power not as some absolute value determined for each state as if it were in a vaccum but, rather, as capabilities relative to the capabilities of other states." (See Paul R. Viotti and Mark V. Kauppi, 2ed edition, *International Relations Theory; Realism, Pluralism, Globalism*, MacMillan Publishing, NY, 1993, pp.44).

[286] However, historical experiences changed this perception. As Anthony McGrew observed, "… the mass mobilization of societies demanded by industrial warfar altered liberal attitudes to state intervention. If the state could mobilized societal resources for the war effort, then government could act to improve the human condition." See Anthony McGrew, "Liberal Internationalism: Between Realism and Cosmopolitanism", pp. 271, in David Held and Anthony McGrew, edited, *Governing Globalization: power, Authority and Global Governance,* Blackwell Publisher, 2002.

within a given state, so too did liberal thinkers argue that a harmony of interest among states was possible.

Overall, Liberals made at least four arguments. First, they claim that the expansion of the international economy made it more costly for states to embark on war. As economic interdependence increased, there would be a reluctance to cut profitable economic ties.[287] Second, they maintain that the spread of democratic (or more precisely republican or representative) political system meant that question of war and peace were no longer confined to small group of political and military elites, as in the past. Third argument is related to the benefits of international law, accepted "role of the game," and international organizations would contribute to the peaceful settlement of disputes among states and enhance global cooperation.[288] Finally, they argue that Western civilization had suffered enough from war and those leaders and citizens had learned how costly it was to wage.

If classical liberal theorists were seeking peace through harmony of interest between states, the historical experiences of the twentieth century most notably two World Wars, the Great Depression in addition to the success of international public unions compels liberal thinkers to alter their view on world peace. The new brand of liberal thinkers, commonly known as *liberal internationalists*, begun to contemplate some form of international order, especially (as John Maynard Keynes and other argued) in respect of economic and social affairs.[289] In short, liberal internationalists seek to achieve the promised peace by, what McGrew called, *domestication* of the world order. Accordingly, "the new liberalism advocates a form of international government which appropriate power and authority to enforce the peace."[290] This inclination, according to McGrew, advocated a decentralized and pluralistic system of international governance, which is empowered by supranational authority.[291]

Nevertheless, over the years, liberal thinking has changed according to historical experiences, their philosophical foundation remained intact – *reason* has been a substitute for the use of force in world politics and as Doyle asserts the world politics can be a state of peace.[292] In this respect, Immanuel Kant's work plays a major role in cementing the liberal base. For instance, Cederman points out, Kant's essay "Perpetual Peace,"[293] sets out three "definitive articles," as joint conditions for truly

[287] A work in this tradition is; Richard Rosecrance, *The Rise of the Trading System*, Basic Book, 1986.

[288] See Robert O, Keohane, "International Liberalism Reconsidered," in *The Economic Limits to Modern Politics*, ed. John Dunn, Cambridge University Press, 1990, pp. 165–90.

[289] It should be noted that while the majority perceived the Great Depression ended as a result of Keynes economic policy, others, like John Kenneth Galbraith, argue that the Great Depression ended as a result of the World War II.

[290] Anthony McGrew, 2002, pp. 217.

[291] Ibid. As an ample example of such system one can recalls *Woodrow Wilson's Fourteen Points.*

[292] Michael W. Doyle, Ways of War and Peace, W. W. Norton, 1997.

[293] Immanuel, Kant, *Perpetual Peace*. Edited by Lewis White Beck, Macmillan, 1957.

lasting peace.[294] The *first* definitive article, "The Civil Constitution of Every Sate Should Be Republican" requires states to be republics, which in today's terminology could be translated as representative liberal states.[295] Jahn further explains, "Because citizens bears the burden of war, they are generally inclined toward caution; and republics, in which the citizens' opinions are represented, are therefore less war prone than other forms of government."[296]

Kant's the *second* definitive, "The Law of Nations Shall be Founded on a Federation of Free States," which a liberal republican form of government (that is, constitutional government based on the consent of citizens) was an essential building blocks of a peaceful international order. According to Kant. "This would be a league of nations, but it would not have to be a state consisting of nation."[297] Kant further explains, "This league does not tend to any dominion over the power of the state but only to the maintenance and security of the freedom of the state itself and of other states in league with it."[298]

The third definitive, "The Law of World Citizenship Shall Be Limited to Conditions of Universal Hospitality," advocated the importance of international law to the maintenance of international order. As McGrew observed, "Just as Liberal republic government required a constitutional order, so international politics required a codification of states' rights and duties."[299] Hospitality, Kant explains, "means the right of a stranger not to be treated as an enemy when he arrives on the land of others."[300] Moreover, in this definitive article Kant proposed a framework of

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[294] Lars-Erik Cederman, "Back to Kant: Reinterpreting the Democratic Peace as a Macrohistorical Learning Process", *The American Political Science Review*, Vol. 95, no. 1, March 2001, pp.15–31. See also Paul R. Viotti and Mark V. Kauppi, second edition, *International Relations Theory: Realism, Pluralism, Globalism*, Macmillan Publishing Company, 1993, pp. 231–232.

[295] See David Held, 1995, Introduction chapter. In fact, in the introduction, Held presents an interesting discussion of democracy, Globalization and Global Governance, in terms of: what is relevant constituency: national, regional or international; To whom do decision-makers have to justify their decisions; To whom they should be accountable; etc. Moreover, the term representative liberal states should not be confused with *Jeffersonian democracy*, a term used to indicate the period when the government was run by aristocratic learned men, as opposed to the period of *Jacksonian democracy* where the common man ran the government.

[296] Beate Jahn. "Kant, Mill, and Illiberal Legacies in International Affairs", *International Organization*, Vol. 59, No. 1 (Winter, 2005), pp. 180.

[297] Immanuel Kant, 1957, pp. 16.

[298] Ibid, pp. 18.

[299] Anthony McGrew, 2002, pp.270.

[300] Immanuel Kant, 1957, pp. 20. The acts that harm others are proscribed by Confucius's Golden Rule, which stated, "Do not impose on others what you do not wish for yourself." Adam Smith also expressed the similar sentiment: "Every man is, no doubt, by nature first and principally recommended to his own care (Smith, Adam, *The Theory of Moral Sentiments, or An Essay Toward an Analysis of the Principles by which Men Naturally Judge Concerning the Conduct and Character First of the Neighbours and then of Themselves*, 11th ed., Edinburgh: Bell and Bradfute, 1759; 1808, I, pp. 193), but he goes on: "Although the ruin of our neighbour may affect us less than a very small misfortune of our own, we must not ruin him to prevent that small misfortune, or even to prevent our own ruin" (ibid., pp. 194)."

cosmopolitan law (*ius cosmopoliticum*[301]) that intended to achieve peace through the right and duties of both individuals and nations within his proposed league of state. The basic idea of cosmopolitan law[302] involved the notion of each person is "a citizen of the world" and owes a duty, above all, "to the worldwide community of human beings."[303] As Kant expressed, "Since the narrow or wider community of the peoples of the earth has developed so far that a violation of right in one place is felt throughout the world, the idea of a law of world citizenship is no high-flown or exaggerated notion."[304] The concept of citizen of the world further strengthen the liberal notion in a sense that a stable peace can only be realized by abounding power politics and constructed an ideal that distinguishes them from "realist" thinker who promotes the balance of power as the best way to reached lasting peace (or prevent war by deterrence).

And yet, these hypothetical conditions presented by the liberal ideal can only prevail in a representative liberal democracy (according to Kant's first article). Another way of saying the same thing is that a world lasting peace is only a possible in a *liberal-harmonized-world*. In this respect, effectiveness of liberal global institutions, e.g., global governance, in pursuing their objective to create a stable-world can only be realized through a systematic promotion of "liberal principles abroad."

This can be accomplished only through selection of liberal thoughts and practices, an argument that was put forward by State of World Forum's Commission on Globalization in 2003, "As the twenty-first century unfolds, an ever more integrated global system demands an ever more inclusive and holistic approach to global governance. More than ever before in history, we need the rigorous application of best thinking and best practices to the management of global systems. Nothing less will suffice, if we are to secure the well-being of our children and protect the fragile web of life that supports and nurtures humanity's existence on this planet."[305]

The spread of liberalism and effective promotion of liberal ideals by global governance, however, entails establishment of certain necessities both in terms of overall orientation and implementation of policy objectives. First, target nation-states have to be identified, and therefore the world must be separated into two stratums, namely, liberal and nonliberal states. Second, credibility of the policy declaration must be established – the nonliberal states should be hold to the *same standard* that expected of liberal states, as Doyle observed "there are no special

[301] Kant defines *ius cosmopoliticum* as the "constitution conforming to the law of world citizenship, so far as men and states are considered as a universal state of men, in their external mutual relationships." See Kant, *Perpetual Peace*, Section II, Note 3.

[302] For comprehensive analysis of the notion see David Held, "Cosmopolitanism: Ideas, realities and Deficits", in Anthony McGrew and David Held, 2002.

[303] M. C., Nussbaum, "Patriotism and Cosmopolitanism" pp. 4, in J. Cohen, edited, *For Love of Country: Debating the Limits of Patriotism*, Beacon Press, 1996.

[304] Kant, Immanuel, 1957, pp.23.

[305] "Commission Overview: Strategic Context – The Challenged of Globalization," at http://www.worldforum.org/Commission-On-Globalisation/overview/main.htm.

geopolitical clients, no geopolitical enemies other than those judge to be such by liberal principles."[306] As mentioned before, to ascertain the value of policy objective, nation-states "requires abandoning the national interests" as a guidelines to policy-making. Doyle further explains that in the global system of governance, "we must have no liberal enemies and no unconditional alliances states."[307]

Even in various technical areas such as financial stability, trade rules, monetary regime, or accounting standards, the national policy guidelines including the choice of goals and outcomes, should reflects the liberal values, which mirror of the interest of those who control the process, namely, global mechanism of governance.[308] In short, a nation-state, as a sovereign entity, turns into coordinating entity to meet the global economic demands. This recipe, however, does not fit well with the original idea that put forward by liberal thinkers.[309] What prevails, observed Guehenno, "is not a political body but an apparently seamless fabric, an indefinite accretion of interdependent elements."[310]

These prerequisites intend to imply that the membership in prosper liberal zone is exclusive right of those with whom global governance share similar values. More importantly, the creation of different zones (us vs. them) does indicate that beneficial economic outcomes, which can only be realized in the liberal market economic system, go only to the liberal family of nation-states.[311] This is an incentive for nations-sates to converge into the liberal zone, and hence form the notion of "global economic system." This system is also replete with its own global mechanism of governance, whether it is international institutional setting like G-20, coordinating agencies like the World Bank, or disciplines of the neoliberal economic principles, such that nation-states and people are increasingly the subject of prevailing global

[306] Michael, Doyle, 1996, pp. 50.

[307] Ibid.

[308] See David held and Anthony McGrew, 2002, pp. 37.

[309] For instance, Schmitt argues in *Political Theology* that legal order ultimately rests upon the decisions of the sovereign. According to Schmitt, only the sovereign can meet the needs of an "exceptional" time and transcend legal order so that order can then be reestablished. Convinced that the state is governed by the ever-present possibility of conflict, Schmitt theorizes that the state exists only to maintain its integrity to ensure order and stability. Suggesting that all concepts of modern political thought are secularized theological concepts, Schmitt concludes *Political Theology* with a critique of liberalism and its attempt to depoliticize political thought by avoiding fundamental political decisions (see Carl Schmitt, George Schwab, Tracy B. Strong, *Political Theology*, University Of Chicago Press; 1 edition, 2006).

[310] Jean-Marie Guehenno, 2000, pp. 59.

[311] It is interesting to note that a creation of a especial zone has been topic of discussions among liberal economists for many years. For instance, one early venture into this line of investigation was Robert Mundell's "optimum currency area" (see Robert. A. Mundell, "A Theory of Optimum Currency Areas," *American Economic Review*, September 1961, 51, 657–65). Mundell initiated a discussion of how large the area for a single currency should be. He defined an optimum currency area as one where labor moved freely within the area, but not between it and other areas, taking us back to the Ricardian criterion distinguishing domestic from foreign trade: factor mobility within but not between countries.

authorities. The sentiment for global system is also reaffirmed by the State of World Forum (SWF) World-view; the belief that the ill afflicting humanity are "problem" that can be solve if the right principles and tools lead in setting goals and "exercising will."[312]

We are closing this section by pointing out the obvious, the difference between what we intend to do and what is possible under prevailing circumstances. While conceptually setting up conditions to achieve various objectives is similar to create a wish list, in practice these requirements and objectives formulation bear major predicaments and immediate shortfalls, both at national and global levels. At the national level, no matter the expectations laid on governments, especially those of nonliberal states, they are unlikely to comply with the prescribed scenario because (1) government cannot perform certain tasks adequately due to a weak institutional capacity; (2) resource deficiency in a sense that possible governments failure is related to their material, organizational or epistemic resources, which are not sufficient to perform adequately particular functions; and (3) unwillingness of governments in carrying out specific task.[313]

Globally, the liberal argument rests on several presumptions. First, it is the manageability of international affairs through reason and rationality, which are necessary and sufficiently requirements. In effect, through the pursuit of enlightened self-interest and rational consideration, conflict between nation-states can be resolved or/and mutual interest mediated without recourse to power politics (force or war). Second, growing economic interdependencies between nation-states and people entails the necessity for the international regulation (of their common affairs). Third, global institutions contributes to peace and world order either through taming the powerful by creating international norms, incentive and new patterns of multilateral politics which limit the scope of power politics; or/and providing mechanism for preventing/managing interstate conflict. Fourth, "progress is possible in world politics in so far as power politics (and thereby war) is not regarded as a an immutable property of the interstates order (as realism presumed) but on the contrary can

[312] State of the World Forum, "1997 State of the World Forum," at http://worldforum.percepticon.com/1997forum/index.html. However, the form further hints at more general direction, namely "global citizen", as a statement issued by the SWF after its 1997 meeting said: "This effort is being developed in the conviction that the process of globalization is in essence the challenge to envision and create the first global civilization: that the problem of the world are for the first time in history essentially manageable. Given the scientific, political and social tools at our disposal; and that humanity, already cooperation in so many areas, stands potentially ready to envision and implement a common vision of the future. The question is not whether we can accomplish these things. We know we can. The question is that of setting priorities, reaching consensus, mobilizing and exercising will."

[313] As Jahn observed, "While democratic peace theorists do not discuss the question of consent explicitly in this context, it nevertheless lies at the heart of liberal thought in general and of the democratic peace thesis in particular. After all, liberal constitutions derive their legitimacy from consent, and the presumed lack of consent in nonliberal states deprives the latter of this legitimacy." (see Beate Jahn. 2005, pp. 181)

be mitigated, if not transcendent, through the progressive reform or domestication of international affairs (the rule of law, universal human rights, etc.). In this respect liberal internationalism reflects a distinctly Enlightenment commitment to the improvement of the human and global condition."[314] Fifth, governments expect to respond to global economic interdependency by seeking to strengthen and institutionalize cooperation at the international level. This multilateralism will place a new emphasis on global institutions like UN, NATO, the IMF, Bank of International Settlement (BIS), the World Bank, WTO, etc. The expectation is, as Ngaire Woods observed, "multilateral negotiations and a sharing of technical expertise will provide solutions to the new vulnerabilities created by globalization, and that international agencies will then be able to implement these solution."[315]

Finally, the global system assumed to operates independent of the structure of global production and underlying economic power of transnational corporations. Such omission is particularly significant in the prevailing global economic system since change in the structure of global production occurred from "production mostly designed and destined for one local or national market, to production mostly designed and destined for a world market, or at least for several national markets. In short, it is not the enterprises that are multinational. It is the market."[316] Indeed, economic interdependence, or more accurately described integration of the world economy through internationalization of production has shifted the balance of power away from nation-states and toward global markets and global markets agents. This is the topic that will be address in the following section.

Structure of Global Production: Post-Industrial Age

In many respects, there are irrefutable similarities between today world and what is known as the post-industrial era. Most apparent among these resemblances are the increase technical requirement of knowledge, which in turns underlines professional as the central person and the role of services as the pillar of economic system. To confirm these observations, we follow one the most influential studies on the post-industrial society by Daniel Bell. In his classic work, *The Coming of Post-Industrial Society*, Bell claims that the concept of post-industrial society must be examined in light of past trends and evolutions, "the concept of a post-industrial society gains meaning only when it's attributes compare with those of an industrial society and preindustrial society."[317] For him, preindustrial are agrarian-based societies that

[314] Anthony McGrew, 2002, pp. 268.

[315] Ngaire Woods, "Global Governance and the Role of Institutions", pp. 29, in Anthony McGrew and David Held, *Governing Globalization: Power, Authority and Global Governance*, Blackwell Publisher, 2002.

[316] Susan Strange, 1996, pp. 44.

[317] Daniel Bell, *The Coming of Post-Industrial Society: A venture in Social Forecasting*, Basic Book, 1973, pp. 126.

structured "in traditional ways of routine and authority." And yet, the common attribute between preindustrial societies and today world is related to the fact that large portion of labor force is still engaged in extractive industries, as he observed a portion of life today is still "primarily a game against nature."

Bell's Industrial societies are goods producing society, which more or less can be grouped around the North Atlantic littoral in addition to former Soviet Unions and Japan.[318] In these societies, raw muscle is no longer provides the power for the basis of productivity, but instead "energy and machines transform the nature of work." The Industrial world, "is a world of organization – of hierarchy and bureaucracy – in which men are treated as 'things' because one can more easily coordinate things than men"[319] The attribute that is intrinsic to a capital-based market system. However, and as the twentieth century ended, the failure of industrialization to deliver the prosperity at the global level stunned many. As Alvin Toffler observed in 1980, industrialization "left behind a world in which one quarter on the [people] live in relative affluent, three quarter in relative poverty – and 800, 000,000 in what the World bank terms 'absolute' poverty. Fully 700,000,000 people were underfed and 550,000,000 illiterate. An estimated 1,200,000,000 human beings remained without access to the public health facilities or even safe, drinkable water, as industrial age ended."[320]

Bell also observes that educated and skillful individuals play major role in operation of the post-industrial society to the extent that professionals make up the core of guiding principles. This, in turns, requires greater technical requirements of knowledge (professionalization, meritocracy, epistemic community) in the decision making of organization that control individual lives like education, health and well-being, operation of economic, etc. According to Bell this "knowledge class" has becomes the central occupational category in society today to the extent that it "has outdistanced all other major occupational groups in recent decades."[321] Consequently, as Bell observed, what matter the most in the postindustrial society is not a raw muscle power, or energy, but information, "Information becomes a central resource, and within organizations a source of power."[322]

Bell, like some others, e.g., Warren Weaver, sees progress within the knowledge class as well as advancements in science as the vehicle to solve the major problem, or using Weaver's metaphor "organized complexity," of the postindustrial era.

[318] However, Bell later clarified his position and pointed out, "if an industrial society is defined as a good-producing society – if manufacturing is central in shaping the character of its labor – then the United States is no longer an industrial society." Ibid. pp. 133.

[319] Ibid. pp. 127.

[320] Alvin Toffler, *The Third Wave*, William Morrow and Company, 1980, pp. 345.

[321] Daniel Bell, 1973, pp.137.

[322] Ibid. pp. 128. The reader should note that professionalization of policy decision making means breaking down of the process into information bits, which in turn implies simplification of perception – whether knowledge class does considered an issue or not (or talk about or not) – for an issue that is not considered (talked about) does not exist.

Using Weaver writing Bell explains organized complexity as, "the management of large-scale system, with large number of interacting variables, which have to be coordinated to achieve specific goals."[323] In his view, the application of what he called "intellectual technology," that is, progressions of knowledge like information theory, decision theory, utility theory in addition to technological advancements like cybernetics and stochastic processes, have been successfully applied to resolve organized complicity.[324] The striking distinctive of the prevailing decision-making process, and more importantly its knowledge-class, is its given right to define these rational instructions and uncontested (assumed) will to identify the means of implementing them.[325] This alteration in a decision making process, in fact, magnified the important of an *epistemic thinking and community* in decision-making and policy formulation (both at national and international level) to the extent that political power has passed to a new class of technical experts who dominate access to information and knowledge.[326]

More importantly, technological developments, e.g., communication infrastructure, interaction and communication led to interconnections of vast population of the globe, and hence established *the global network* that bears profound consequences. For instance, internet "changes the nature of the 'gatekeepers', the one who determine or shape the tastes of those within a like-mind circle, who influence the acceptance or rejection of new style, products, entertainment, and so on."[327] For one thing, the global network initiates the process that underlines the importance of *social networking* and *social influence*, and hence raises the awareness of new possibilities. Indeed, the political movements, also known as "twitter revolution," in North Africa and Near East in recent months are ample indication of this trend.[328] These developments, in turn, lead to uncertain outcomes. For instance, they may tend to drive other nations to follow the same path, just like the similar movements

[323] Ibid. pp. 29.

[324] The reader should note that these developments share one common theme, that is, technical decision making of the post-industrial era is stripes from the ideological-base. Unlike traditional thinking that bears emotional and expressive notions, technical decision-making is algorithms embodied in set of rational instructions.

[325] However, it is important to note a fundamental shortfall in such procedure. The prevailing knowledge class is obviously made up of various groups, where each group does not have to give up its own rationality since each quite easily accepts (does not dispute) the rationality of others. In this respect, there are no incentives to improve these rational instructions since for their construction, there are only methods put forward by progress of science.

[326] The reader should note, however, that knowledge in the present content does not consist in discovering some essential truth, but in collecting new information. It is never ending search since the primary goal of knowledge in the network society is gathering information to no end.

[327] Daniel Bell, *The Coming of Post-Industrial Society: A Venture in Social Forecasting*, Foreword 1999, Basic Book, 1976, pp. vii.

[328] For instance, read the Washington Times editorial comment called, "Iran's Twitter revolution, Tuseday, June 16, 2009. It can be accessed at http://www.washingtontimes.com/news/2009/jun/16/irans-twitter-revolution/.

within the West did, in a sense that no established institutions will be immune from consequences of their repressive actions. Or, as observed by Guehenno observes, “Like the Roman citizen of the time of Caracalla, the citizen of the imperial age of the networks defines himself less and less by his participation in the exercise of sovereignty and more and more by the possibility he has to act in a framework in which the procedures obey clear and predicable rules.”[329]

And yet, one, with significant degree of certainty, can noted that professionals (individuals) create a field of forces, of information/knowledge imbalances (tensions), wherein the tendency to increase the one’s dependency is offset by anxiety of losing control of the networks that have already become inseparable part of the global economic system. In this respect, the global system is becoming a perpetual stock exchange of information. The more information there is, the more imbalances there are. For instance, October 1987 crashed provides an ample evidence of these imbalances; as Edward Lorenz observed, “one flap of a seagull’s wings could change the course of weather forever.”[330]

In terms of the second similarity (services and their impacts), Bell’s analysis of the post-industrial society declared, “A post-industrial society is based on services.”[331] However, since Bell mainly concerned with the social structural and political consequences of the post-industrial society, he neither examined the attributes of services industry, nor its possible impact on production structure as well as structure of economic system. Consequently, he only sees significant of services by the change in *sector distribution* – the places where people work as well as *pattern of occupation* – the kind of work they do.

In spite of Bell’s analysis, services imply much deeper alteration an economic system to the extent that one can claims that the rise in services is the major part of the prevailing global economic system both in terms of the production as well as the structure of economy.[332] According to the World Bank Atlas of Global Development “Service, the most rapidly growing sector of the global economy, now account for almost 70% of world output… In many high-income economies more than 70% of GDP is produced in the service sector… Services now account for 54% of output of

[329] Jean-marie Guehenno, 2000, pp. 58.

[330] This is commonly known as the *butterfly effect*. It is a metaphor that encapsulates the concept of *sensitive dependence on initial conditions* in chaos theory; namely, a small change at one place in a complex system can have large effects elsewhere. For more information see Wikipedia, under the subject Butterfly effect.

[331] Bell, 1973, pp. 127.

[332] The reader should note that this rise implies declined in other economic sectors like manufacturing. Some believed the prevailing gap can be due to the fact that while official data on manufacturing is precise and clear, measurement of the service sector is vague and imprecise. This is due to the fact that for many decades official data were mainly concerned with measure of manufacturing sector. For more information on this topic see David M. Smick, *The World Is Curved: Hidden Dangers to the Global Economy*, Penguin, 2009.

middle-income economies."[333] This change is associated to the rise post-industrial economy.[334] As Held and McGrew observed, "Over recent decades, the core economies in the global system have undergone a profound economic restructuring. In the process they have been transformation from essentially industrial to post-industrial economies. Just as the twentieth century witnessed the global diffusion of industrial capitalism, so at the century's end post-industrial began to take its place."[335]

Mode of Global Production

There is no such thing as a consensus when one considers the prevailing trend in the global economy. A dozen experts will arrive at 12 different conclusions. It often happens that a few moments later each would alter his/her verdict if given a chance to reconsider because of a sheer size of the global system and speed in which things can happen. Nevertheless, one thing is certain, that is, "value" is less and less associated with production. This is due, partly, because traditional sectors like agriculture and industry represent a decreasing part of global economic system. Today, "Information and Communication technologies provide the backbone for the knowledge economy. They account for around half of the productivity growth in modern world."[336] However, and more importantly, scarcity does not determine the value any longer since we are encountering immaterial economy at the global scale.[337]

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[333] *Atlas of Global Development: A Visual Guide to the World's Greatest Challenges*, 2ed edition, World Bank Group publication, 2009, pp. 56–7. See also Francisco J. Buera, Joseph P. Kaboski, "The Rise of the Service Economy," *NBER Working Paper* no. 14822, March 2009.

[334] In fairness to the reader, we should like to note that there are those who not only refute such conclusion but also considered the entire notion of post-industrial economy as a myth. For instance, Cohen and Zysman, observed that "the growth of service employment, even of white collar employment, has not put an end to labor struggles and class conflicts of earlier industrial period. Whatever its merits as a principle for organizing our understanding of sociological change, we have yet to arrive at post-industrial politics. Nor is there post-industrial economics." See Stephen S. Cohen and John Zysman, *Manufacturing Matters: The Myth of the Post-Industrial Economy*, Basic book, 1987, pp. 260.

[335] David Held and Anthony McGrew, "The Great Globalization Debate: An Introduction" in David Held and Anthony McGrew, edited, *The Global Transformations Reader: An Introduction to the Globalization Debate*, 2edn, Polity Press, 2003, pp. 25.

[336] *ICT – Information and Communication Technologies*, European Commission, Working Program 2007–2008, Draft version 1. Can be access at *docs.thinkfree.com/tools/download.php?mode=down&dsn=454628,* pp. 4. See also http://www.global-production.com/electronics/trendstudy/.

[337] For instance, domination of the service industry implies immaterial products, which drive their development from exchange – value is drive more from a transaction than production. Consequently, since they are immaterial, orthodox economic policies such as lowering custom tariff are ineffective since they never physically cross a border. However, harmonization of internal regulation relative to global standard is effective practice to expand services, so that a bank or an insurance company can install itself in the country of its choice.

In this respect, Guehenno observed, “This revolution of the economy diminishes the value of space and increases the value of men – for rarity, which determines value, has changed, for space as it has for men.”[338] For instance, following the trend of the past 50 years, the price of land, on average and over time, is not related to what it can produce, but rather to people who can settle on it (real states). Or, in car manufacturing, one of the major industrial productions of the first half of the twentieth century, raw materials represent between 30 and 40% of its value. Today, however, in production of electronic components, the major component of knowledge economy and the symbol of the new age, raw materials barely represent 1%.[339] This trend suggests global production becoming more abstract, more immaterial in a sense that wealth of nation has become less and less tangible. As Klein observed, “many of today’s best-known manufactures no longer produce products and advertise them, but rather buy products and *bran* them.”[340]

In related issue, the 2006 World Bank study called, “Where is Wealth of Nations?” explores this question: “Why do highly industrialized economies like the U.S., succeed economically while some less developed economies with ample resources do poorly?” The study concludes that the difference is that the USA and other industrialized economies enjoy an enormous amount of “intangible wealth.” The rise of intangible wealth bears two distinct consequences. First, in the formation of value, it is increasingly difficult to determine locality of its material components. Guehenno sees the main cause of this development in telecommunication revolution, the network economy and rise in the capacity to be accessed. He claimed, “Someone who has access to the files of the fifty thousand richest people in France is wealthier than a jeweler who owns a gold brooch: as soon as penury disappeared, value, was created in bringing the right offer with the right demand.”[341] Second, institutions and institutional settings/environments become dominating force in the global economic system. As David Smick concludes, “Total wealth is an economy involves more than compiling a list a country’s physical and financial assets. Wealth involves intangible assets such as property rights, an honest and efficient judicial system backed by the rule of law, a workable government, an appreciation for and nurturing of human capital, and I would add, a tolerance of and even appreciation for entrepreneurial creativity and risk.”[342]

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[338] Jean-Marie Guehenno, 2000, pp. 9.

[339] *ICT – Information and Communication Technologies*, European Commission, Working Program 2007–2008, Draft version 1. Can be access at *docs.thinkfree.com/tools/download.php?mode=down&dsn=454628*. See also http://www.global-production.com/electronics/trend-study/. The report also stated, “Information and Communication technologies provide the backbone for the knowledge economy. They account for around half of the productivity growth in modern economies.”

[340] Naomi Kline, *No Logo*, 10th Anniversary Edition, Picador, 2010, pp. 5.

[341] Jean-Marie Guehenno, 2000, pp. 8.

[342] David M. Smick, *The World Is Curved: Hidden Dangers to the Global Economy*, Penguin Group, 2008, pp. 85.

In the related literature, these developments were introduced through various descriptions, such as "global information capitalism,"[343] "manic capitalism,"[344] "turbo-capitalism,"[345] or "supra-territorial capitalism,"[346] all of which sought to capture the essence of the change in structure of global production and the dynamic of global organization. Yet, most descriptions lack clarity and preciseness either in their descriptions, or in their illustrative language (terminologies). Thus, to avoid similar pseudo observation, or usage of imprecise terminologies let us review the meaning of "change" in the "structure" of global "production," and hence reached an accurate understand of the notions under consideration.

Changes, like disturbances, generally are integral part of natural evolution of any mechanism, which either can be offset by mobilizing strength from other parts of the system or create new set of conditions as a result of their interactions with the other components of the system. Change does occur at all levels – in structure of productions, in social relations, and in political orders and mechanisms of governance. However, the point is that in today global arrangement, the notion of economic "change" is mostly due to change in global economic exchanges. We can no longer considered economics within countries – or what traditionally call "domestic" or "national" – without taken into consideration the nature of the linkages between national economies and the global economy, and alterations in such linkages. In this respect, a change in a country's production structure often reflects a boarder changes that occurs in the global economic system in a sense that competition (between various economies) for wealth-producing resources occurs in the world market. Central to this argument is the fact that prevailing change in world production structures created both new possibilities for wealth-creation, and new challenges for states as to how to balance the often confliction demands of their national and international agendas.

By definition, the structure of an economy is a function of the sum of all the different economic activities in the geo-political boundaries of that area. Respectively, structural features are the outcome of the dynamic interaction of economic, social and political factors, which defined particular periods and are always changing.[347] For instance, one of the main structural features of the prevailing global economic system is the explosive growth of the financial system relative to manufacturing and the economy as a whole. Generally, these features may be restructured either by

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343 For instance see Eric Louw, *The Media and Cultural Production*, Sage Publications Ltd, 2001.

344 For instance see Jean Hillier, Jean Hillier, and Emma Rooks, edited, Ashgate Publishing, 2005. In this book "manic capitalism" is described as "a frenetic economic system embodying an intense and uncontrollable dynamic of competitive activity driven as much by corruption, marketeering, speculation, profiteering and mismanagement as by genuine ordered economic exchange," pp. 96

345 For instance see Edward N. Luttwak, Weidenfeld and Nicolson, *Turbo-Capitalism: Winners and Losers in the Global Economy*, Harper Perennial, 2000.

346 For instance see by Jan Aart Scholte, *Globalization: A Critical Introduction,* Palgrave Macmillan, 2000.

347 Joyce Kolko, *Restructuring the World Economy*, Pantheon Books, 1988, pp. 9

objective forces or by subjective design, which in this case outcome is rarely achieved as intended.[348] They also can be introduced by historical events, e.g., economic crisis, by major development in science and technology, or by more change in the political order. However, it is imprudent to formulate a theoretical ground to explain structural features during a pacific period since they are not static and various factors (both within and outside their locality) may alter, reconstructed or even replace them. Having said that, to define the specific character of a period one can and should identify these features in the context of political economy, which deals with production and distribution and consumption of goods and services and their management.

In the prevailing global economic system, because of sheer number of economies operating in the global system, the structural features do not evolved in sequential and connected order – an evolutionary process that one can observed and extrapolate into the future – but rather they changed according to their interactions within the global system as whole, which usually resulted in creation entirely a new setting(s). For instance, the wide spreads of financial crises (from 1990s onward) occurred in different geographical locations with quite different governmental structures, create a new feature called global governance as expression of necessity to find new methods of corporation and regulation for collective problems. The global governance created through *dialectical interactions*[349] among major economic powers of global system to prevent or/and manage future crises. What emerges is a new setting that intends to secure a stability of post-change, in which one cannot extrapolate into the future development but rather observed as a spontaneous reaction to concurrent events.

Finally, the process of *production* in the conventional literatures is commonly reviewed and categorized as an economic concept.[350] However, to find a mere definition of the term one should go back to Carl Menger's *Principle of Economics* published in 1871. Production, according to Menger, is defined as the process of transforming higher-order goods (refer to goods furthest from consumption) into successively lower-order good (refer to goods closer to consumption).[351] Menger

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[348] Ibid.

[349] A dialectical interaction usually means that two or more groups [representatives of nation-states, global institutions, etc.] with roughly equal status but alternative viewpoints and interests intend to solve a problem or perform a task.

[350] In general, the term production – in German Produktionverhältnisse – refers to those relationships which arise out of the actual production process and also, of course, to ownership relations of which the most important is property. In the domain of conventional economic, the notion of production is perceived as mathematical derivative, which either takes a functional form, i.e., production function, or as curvature arrangement, i.e., production possibility curve, which indicates the different mixes or ranges of goods (usually two) that could be produced if an economy exploited all available workers, technologies, land, capital, and other resources to the full.

[351] In terms of terminology used, Mark Skousen explains, "Menger's choice of terminology 'higher' and 'lower' orders has been criticized as confusing. Higher order goods may be confused with, e.g., highly finished goods. Perhaps 'early' and 'later' stages are more appropriate." See Mark Skousen, *The Structure of Production*, New York University Press, 1990, pp. 39 ft. 20.

viewed economic production as "the process by which goods of higher order are progressively transformed into goods of lower order and by which these are directed finally to the satisfaction of human needs."[352]

Production also bears political flavor, that is, inputs involved in the production of goods and services, or commonly known as factors of production.[353] For instance, according to Marx, the most fundamental ownership relation, under capitalism at least, is national bourgeois ownership of the means of production, an ownership, which also manifests itself in a monopoly of political power.[354] Ensuing the Marx's argument, Cox observed, "Production creates the material basis for all form of social existence, and the way in which human efforts are combined in productive process affect all other aspects of social life, including the polity. Production generates the capacity to exercise power."[355] Cox further explains that production is not only taken place through a power relationship, but it "also creates resources that can be transformed into other forms of power – financial, administrative, ideological, military, and police power."[356]

In this respect, the control over production process is a direct challenge to authority of a state. Historically, a state acquires its essential material basis from production, which in turn enables it to make a choice regarding various modes of development (prosperity) for the society as a whole. In fact, the core structures of production have been either created, or sustained by any form of state. *Competitive capitalistic state* "required a liberal state in order to break through the shackles of mercantilism."[357] *Bolshevik state* created a central planning to *nationalized* production, that is, state taken over the private production, banking system and the industrial sector. State corporatism of *the fascist state*, which according to Ludwig von Mises never "tolerates anybody's interference with [state] absolute control of

352 Carl Menger, *The Principle of Economics*, Ludwig von Mises Institute, 1976, pp. 67.

353 According to Oxford Dictionary of Politics, "Sir William Petty (1623–1687) first defined land and labour as factors of production. The factors of capital and entrepreneurship were added by the French physiocrats. 'Land' includes resources within the land such as mineral deposits like coal and iron ore. Labour is the human effort, whether manual or mental, that contributes to production. Capital is usually denoted as machinery or tools, which are used in combination with labour for the purpose of making goods. There can be fixed or circulating capital. The former relates to goods such as buildings or machinery while the latter refers to the stock of goods a firm has ready for use in the future. Capital is the only factor of production which itself is created in the production process. Entrepreneurship refers to the managerial, innovative, and risk-taking qualities which an individual displays when combining the other factors of production in order to generate output. The returns or payments to each of these factors are rent for land, wage for labour, interest for capital, and profit for entrepreneurship." See www.answers.com/topic/factors-of-production.

354 See Karl Marx, *Capital: A Critique of Political Economy*, Chapter one.

355 Robert Coc, 1987, pp. 1.

356 Ibid, pp. 5. Moreover, it is noteworthy that Cox's description of production trivialized the Marxian view of national bourgeois ownership, since (as we see in the following pages) ownership of factors of production, land and labor in particular, can be owned locally but significant benefits of their production have been sourced out.

357 Ibid.

production."[358] Accordingly, an alteration in a structure of production implies an alteration in authority of state to exercise power, particularly over economic organization over national production. This led us to the next issue of our concern, which concerns with *economic organization* of a society (or simply organization of production).

To address this issue, we go back to basic economic lessons and appeal to three influential economists, Karl Marx, Frank Knight and Paul Samuelson. One of the Marx's great contributions to the discipline of economics is his realization that distribution of power can only be achieves through change in ownership of means of production, or simply reorganization of production.[359] Marx, in his analysis of production, points out that a position of power is only sustainable through ownership of means of production, and to change this position one must reorganizes production. Indeed, it is the relations of production, which determine the distribution of power. "The subdivisions and organization of distribution are determined by the subdivisions and organization of production not only insofar as the [distribution of] material goods are concerned; but also as regards its form, since the definite manner of participation in production determines the particular form of distribution."[360] In this respect, if the objective of various, and often common, economic policies or programs is to address a socio-economic mechanism and achieve *progressive redistribution* and empowerment, they are ill equipped and policy-makers are misinformed. This is the historical lesson that hardly ever has been learned.

Knight's understanding of economics, as expressed in *The Economic Organization*, is short and to the point, "Economics deals with the *social organization* of economic activity."[361] For Knight, the problem of organization, which sets the problem of economics, therefore, "deals with the concrete means or mechanism for dividing the general function of making a living for people into parts and bringing about the performance of these parts in due proportion and harmony. More specifically, it is a problem of social machinery for accomplishing *five fairly distinct functions*."[362]

[358] Ludwig von Mises, 2nd edition, *Socialism: An Economic and Sociological Analysis*, translated by J. Kahane, Liberty, Indianapolis, 1932, pp. 527.

[359] As we will show later, the concept of internationalization of resources, that is, reorganization of production and its ownership (from national sovereign state to international economic entities) is an ample example of such redistribution of power from national authorities to international sources, e.g., corporations.

[360] Karl Marx, *A Contribution to the Critique of Political Economy*, translated from the Second Edition by N. I. Stone, Charles H. Kerr and Company, Chicago, 1904, pp. 284.

[361] Frank Knight, The Economic Organization, Harper and Row Publishers, 1933, pp. 6 (italics in original).

[362] Ibid, pp. 7 (italics in original). The reader should note that Roos Emmett used the exact quotation to illustrate why Knight does not perceived economics as a equivalent to the science of rational action. As Emmett observed, "The first reason Knight gives is that economics deals with social organization of human economizing activity – 'the concrete means or mechanism for dividing the general function of making a living for the people into parts and bringing about the performance of these parts in due proportion and harmony' – rather than with the process of making a living itself." See Roos B. Emmett, *Frank Knight and the Chicago School in American Economics*, Taylor and Francis, Inc. 2009, pp. 166.

For our purposes here, we only focus on the second function, the function of *organizing production*, which implies "putting them [production] to use in accordance with the scale of values thus established."

Knight breaks this function into two features (a) the assignment or *allocation* of the available productive forces and materials among the various lines of industry, and (b) the effective *coordination* of the various means of production in each industry into such a groupings as will produce the greater result."[363] While, Knight did not explicitly indicate who is responsible to conduct these tasks, his definition of economics as a social organization and his trust on a liberal society means that the capable body to take on such responsibility and to exercise power over the economy is the state. Accordingly, a state that is incapable to exercise power over the economic affairs will eventually failed not only to meet, but also to conduct, these tasks.

Finally, in 1948, Paul Samuelson in his introductory economics textbook, underlined the fundamental problem of economic organization, in which he explains, "Any society, whether it consists of a totally collectivized communistic state, a tribe of South Sea Islanders, a capitalistic industrial nation, A Swiss Family Robinson or Robinson Crusoe, and one might almost add, a colony of bees, must somehow meet three fundamental economic problems. (1) *What* commodities shall be produced and in what quantities? That is, how much and which of many alternative goods and services shall be produced? (2) *How* shall they be produced? That is by whom and with what resources and in what technological manner are they to be produced? (3) *For whom* are they to be produced? That is, who is to enjoy and get the benefit of the goods and services provided? Or, to put the same thing in another way, how is the total of national product to be distributed among different individuals and families?"[364] Samuelson concern with the fundamental problem of economic organization was with; what should be produced in the economy; how within the existing factors of production (land, labor, capital, and technology) should be produced; and for whom the output should be produced. In short, who does what to whom and who must paid for it?[365] Addressing the Samuelson's questions, in turn, paved the path to the fundamental realization of the global economic system. There is the global production structure, in which power is exercised over what is to be produced, where, and by whom on what terms and conditions. Another way of saying the same thing is that power is exercised, within and across national boundaries, by those who are in position to change structure of production and organization of an economy for their own advantage.

[363] Ibid, pp. 10 (italics in original).

[364] Paul Samuelson, *Economics: The Original 1948 Edition*, first edition, McGraw-Hill/Irwin, 1997, pp. 12–13.

[365] It should be noted that the interpretation of these issues is matter of expertise and field of studies. For instance, in political science the issue concerning for whom deals with whose interest are being served (through policy decisions and formulation) and Whose welfare is being ignored (See Eyal Benvenisti and Georg Nolte, edited, *The Welfare State, Globalization, and International Law*, Springer-Verlag, 2007; and Dexter Whitfield, *Public Services Or Corporate Welfare: Rethinking the Nation State in the Global Economy*, Pluto Press, 2001).

Contributing Factors to Change in Structure of Global Production

The change in structure of global production can be direct result of several factors, e.g., declined in transportation cost, advancements in technology, significant of service industry, but most importantly the rise of global production sharing, as a new form of production.[366] This new form as Wim Naude suggested, is unbundling of production processes, which enable firms greater mobility and increased spatial concentration of industry.[367] In the related literature, this new form of production is known as *international sourcing* in which "a good may be assembled in one country from components produced in other countries, and these in turn may be assembled

[366] Some authors used the notion of *Internationalization*, to illustrate various denotations and implies numerous connotations, all of which depend on the context, in which the notion is defined. Respectively, the term used here is utterly different from terms like internationalization of production, which is measured by the ratio of direct investment abroad to domestic wealth or assets, or of assets or employment abroad to that at home (see Robert E. Lipsey, "The Internationalization of Production," NBER Working paper no. 2923, April 1989). The term is also used to illustrates submissiveness of national policies to international order (see Robert O. Keohane and Helen V. Milner, edited, *Internationalization and Domestic Politics*, Cambridge University Press, 1996) or generally applied in business and management field (see David Frederick Ross, *Distribution: Planning and Control – Managing in the Era of Supply Chain Management*, 2nd edition, Springer Netherlands, 2004, pp. 683).

By the same token, international sourcing can be equivalent of several commonly used terminologies like outsourcing. According to CIO site, "There are as many definitions of outsourcing as there are ways to screw it up. But at its most basic, outsourcing is simply the farming out of services to a third party. With regards to information technology, outsourcing can include anything from outsourcing all management of IT to an IBM (IBM) or HP, to outsourcing a very small and easily defined service, such as disaster recovery or data storage, and everything in between. The term outsourcing is often used interchangeably – and incorrectly – with offshoring, usually by those in a heated debate. Offshoring (or, more accurately, offshore outsourcing) is, in fact, a small but important subset of outsourcing: It's where a company outsources services to a third party in a country other than the one in which the client company is based, primarily to take advantage of lower labor costs. Offshoring has proven to be a political hot potato because unlike domestic outsourcing, in which employees often have the opportunity to keep their jobs and transfer to the outsourcer, offshore outsourcing is more likely to result in layoffs (See http://www.cio.com/article/40380/Outsourcing_Definition_and_Solutions#1).

Finally, there are still more terminologies that implies the similar connotations, terms such as licensing; direct investment; joint venture; and a new growing phenomenon of late 1980s – the establishment of new venture that are international from inception, often raise capital and sell products on several continents – known as new international venture (NIV). For more information on NIV see Benjamin M Oviatt' and Patricia Phillips McDougall, "Toward a theory of international new venture," Journal of international Business Studies, 2005, vol. 36, pp. 29–41. For definition of various terms see Richard L. Daft, *Management*, 9th edition, South Western Educational, 2009.

[367] Wim Naudé, "New Challenges for Industrial Policy," *UNU-WIDER*, working paper no. 2010/107 September 2010.

from subcomponents produced in yet other countries."[368] For instance, Volkswagen's international sourcing network covers four continents, from Asia to Africa and from Europe to North and South America.[369] Another example of international sourcing can be found in Joseph Stiglitz's *Principle of Macroeconomic* textbook in which he illustrated that the production of a Ford Escort in Europe involves 13th European countries plus Japan and the USA.[370] David Levy's work on international production and sourcing in OECD economies also illustrated that the ratio of goods sourced aboard to goods sourced nationally continuously increased in each of the survey countries.[371]

The process of international sourcing bears significant consequences, most importantly among them is the affect it has on a national government to the extent that state's authority to exercise power over the national economic affairs and structure has diminished. Of course, the observation that the territorial boundaries of sates no longer coincide with authority over economy is not original. Indeed, similar opinions are on rise since study of globalization enters into its maturity and consequences of the single economic system become more apparent both in their formation and their impact. Held and McGrew called subscribers of this view, "hyper-globalizers" who "argue that economic globalization is bringing about a 'denationalization' of economies through the establishment of transnational networks of production, trade and finance."[372] Mann also observed that, "For much of the world a *true* nation-state remains more aspiration for the future than present reality."[373]

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[368] Wolfgang H. Reinicke, *Global Public Policy; Governing without Government*, Brooking Institutions Press, 1998, pp. 27–8. The reader should note that international sourcing trends are also observed by many scholars. For instance, Paul Krugman, Richard N. Cooper, and T. N. Srinivasan noted that as a result of international sourcing, the trade involve in the global production of a finished good may easily be several time the value added through all the stages of its production, or what they called the slicing-up of value added (See Paul Krugman Richard N. Cooper, T. N. Srinivasan, "Growing World Trade: Causes and Consequences," *Brookings Papers on Economic Activity*, vol. 1995, no. 1, 25th Anniversary Issue, 1995, pp. 327–377.) Finally, for more information on international sourcing strategies see Per Servais, "International Sourcing: Entering and Exiting Different Networks," in C. P. Rao, edit, *Globalization and Its Managerial Implication*, ABC-Clio, 2000. In this paper, Servais, discusses the complexities on international sourcing strategies by proposing and outlining a portfolio model with a network approach.

[369] Manfred B. Steger, *Globalization: A Brief insight*, Sterling, 2009, pp. 65.

[370] Joseph E. Stiglitz, 2nd edition, *Principle of Macroeconomic*, W. W. Norton, 1997, pp. 49, Fig. 2.7.

[371] David Levy, "international Production and Sourcing: trends and Issues," Science Technology and Industry Review, no. 13, December 1993, pp. 31, Table 1.

[372] David Held and Anthony McGrew, 1999, pp. 3. See also Saskia Sassen, "Globalization or denationalization," *Review of International Political Economy*, 2001, Vol. 10, Issue 1, pp. 1–22; Michael Z Rn, "Globalization and global governance: from societal to political denationalization," *European Review*, 2003, vol. 11, issue 03, pp. 341–364; Markus Jachtenfuchs, "The monopoly of legitimate force: denationalization or business as usual," *European Review*, 2005, vol. 13, issue S1, pp. 37–52; and Michael Zurn, with assistance from Gregor Walter, Edited, *Globalizing Interests: Pressure groups and Denationalization*, State University of New York, 2006.

[373] Michael Mann, "Has Globalization Ended the Rise and Rise of the Nation-State," pp. 137, in David Held and Anthony McGrew, edited, *The Global Transformations Reader: An Introduction to the Globalization Debate*, 2nd Edition, Polity Press, 2001.

Manns' sentiment, however, does not accurately reflect the view we hold or advocate in this book. Our perception is not based on the notion that a nation-state has become redundant or outdated, but rather built on the observation that role of the state in managing economic affairs has declined significantly (in the prevailing structure of global production).[374] This view is supported by both critics of globalization as well as leading political scientists like Robert Gilpin or prominent liberal politicians like Vincent Cable. Gilpin believed that "a profound shift is taking place from a state-dominated to a market-dominated international economy."[375] Gilpin further points out that "the impact of the global economy on individual nations is highly uneven,… While globalization has reduced some policy option, the degree of reduction is highly dependent on national size and economic power."[376] Similarly, Cable observed, "some companies have moved beyond the stage of having subsidiaries in a variety of market (what have been called 'multidomestic' companies) to becoming globally integrated, exploiting advantages of communications technologies and flexible production methods to achieve major economies of scope and coordination, as well as scale. An example is the recent change in the Ford Motor Company's strategy to produce 'global' cars from its several European and American operations."[377]

It is obvious that any assessment of a change in structure of global production and its impact on nation-state is daunting task that entails extreme caution in approach and analysis of the subject.[378] Having said that, however, we must analyze syntax of what is occurring, instead of what "we" hope to occur. In this respect, the prevailing notion of economic interdependence is much-misused concept. For one thing, in the prevailing global environment economic interdependence is the fact. In this context, interdependence necessarily involved closer interaction between nation-states, between nation-states and international organizations, e.g., WTO, between nation-states and firms (including domestic and foreign as well as transnational corporations), and between firms and other firms. These interactions necessarily entail negotiation of the terms of a transaction or agreement. Some of these bargaining are

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[374] For instance, state is still in position to used armed force or not to use it; it has also the right to tax and to print national currency.

[375] Robert Gilpin, *Global Political Economy: Understanding the International Economic Order*, Princeton University Press, 2001, pp. 8.

[376] Robert Gilpin, "The Nation-State in the Global Economy," pp. 351, in David Held and Anthony McGrew, edited, *The Global Transformations Reader: An Introduction to the Globalization Debate*, 2nd Edition, Polity Press, 2001. Gilpin, further elaborate (and not explains) that the USA and Western Europe are much less vulnerable to such reduction in "policy option" than are small economies.

[377] Vincent Cable, "The diminished nation-state: A study in the loss of economic power," *Daedalus*, Spring 1995, 124, 2; Alumni-Research Library, pp. 30

[378] For instance, we refer the reader to Michael Mann, who supports the notion of declined of nation-state authority, but caution us to distinguish: (a) differential impacts on different types of state in different regions; (b) trends weakening and some trends strengthening nation-states; (c) trends displacing national regulation to inter-national as well as to transnational networks; (d) trends simultaneously strengthening nation-states and transnationalism (see Michael Mann, 2001, pp. 145).

struck within boundaries of the countries, and therefore bear the flavor of "domestic policy option." However, the overwhelming portion of these interactions take place outside national foundries, e.g., between various states representatives or between these representatives and international organizations, and hence must be examined and understood in terms of the current international system/order and transnational politics. Under this circumstance, asymmetry of governmental power is bounded to happen and has been a topic of debates for more than 50 years.[379] Accordingly, decline in nation-states authority over national economies, in terms of what, how and for whom to produce, is the uncontested fact in globalized economic system.

Respectively, various scholars and academicians with divers ideological background and affiliations also express the above observation. The only differences among them are their realm of interest and ideas they try to convey to their audiences. For instance, Stopford and Strange explains, "No longer can national boundaries define the rule, for the game is now one where negotiation and action is carried out on triangular basis. The traditional players in the embassies and foreign ministers are still in business, but they have been joined by members of other government ministers and by the executive of firms, both local and multinational. All are now involved in both bilateral and multilateral negotiation."[380] Similar sentiments, which indicate nation-states lost their autonomy and power over their national economic affairs, can also be find among conformist thinkers. Milner and Keohane observed "change in the world economy can alter domestic politics: by creating new policy preferences and coalitions, by triggering domestic economic and political crisis, and by undermining government control."[381] Vincent Cable the current Business Secretary in British Government, in his research for the Royal Institute of International Affairs, underlined two main developments in globalized world, one of which is change in the policy environment, or as he called it "liberalization revolution." According to Cable, the liberalization revolution "freeing up of markets and reduction in the role of government in terms of ownership and control over production of goods and services."[382] Elsewhere, Cable elaborates on the foundation of his

[379] For instance, the literature on the European Community, pioneered by Ernst B. Hass, focused on how economic interdependence affected arrangements for governance (see Ernst B. Hass, *The Uniting of Europe: Political, Economic, and Social Forces*, 1950–1957, Stanford University Press, 1958). Moreover, Karl Kaiser, in 1971 was the first to open discussion on the meaning and significant of interdependence, and pointed to the asymmetry of government power in transnational politics (see Karl Kaiser, "Transnational Politics: Toward a Theory of Multinational Politics," *International Organization*, vol. 25, 1971, pp. 790–817). Later on, in 1977 Keohane and Nye illustrated that interdependence is frequently asymmetrical and highly political: indeed, asymmetries in interdependence generate power resources for both state and nonstate actors (see Robert O. Keohane and Joseph S. Nye, *Power and interdependence*).

[380] John M. Stopford and Susan Strange, *Rival States, Rival Firms: Competition for World Market Shares*, Cambridge University Press, 1991, pp. 21.

[381] Robert O. Keohane and Helen V. Milner, edt, *Internationalization and Domestic Politics*, Cambridge Studies in Comparative Politics, Cambridge University Press, 1996, pp. 243.

[382] Vincent Cable, *Globalization: Rules and Standards for the World Economy*, The Royal Institute of International Affairs, Cassell, 1999, pp. 15.

thinking, "[t]he sheer scale of profit-seeking finance capital that can be mobilized in currency markets far exceeds what any government, or even governments acting in concert can put against it. Foreign exchange trading in the world's financial centers exceeds a trillion dollars a day, a multiple of 50 times, or more, of the daily amount of world trade and greater than the total stock of foreign exchange reserves held by all governments."[383] Guehenno described all that survives, in the prevailing global landscape, "are a plethora of governmental apparatuses, which function according to a patrimonial model of power that is increasingly being liberated from its national dimension."[384] He then continues, "the economy of drug is a good illustration of this bypassing of state by transnational games that are more powerful than are the states themselves. Everywhere that the state is weaken or the climatic conditions are favorable, drugs take root, profoundly transforming society."[385] Paul and Ikenberry, the well-known advocates of nation-state, also indulged the notion of nation-state demised and observed, "Liberalism before nationalism may allow for containment – that is. Respect for historical liberties might allow multinational frames to exist. Voice might create loyalty and so rule out the attraction of exist. Differently put, multinational entities rather than homogeneous nation-states may after all be possible."[386] Oscar Schachter takes on a different angle but makes the similar conclusion by claiming, "A new business class tends to identify itself with the global aims of its transnational companies rather than with the political objectives of its particular countries. The state no longer command the primary allegiance of this class though businessmen will still turn to the state for intervention when it seems useful."[387]

The point we are trying to convey is merely the notion that suggests that decline in national authority to exercise power over the economy should be considered as the natural evolution of the prevailing conditions of globalized economic system.

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[383] Vincent Cable, "The diminished nation-state: A study in the loss of economic power," *Daedalus*, Spring 1995, vol. 124, no. 2, pp. 27.

[384] Jean-Marie Guehenno, 1st edition, *End of the Nation-State*, University Of Minnesota Press, 2000, pp. 3.

[385] Ibid.

[386] T. V. Paul, G. John Ikenberry, *The Nation-State in Question*, Princeton University Press, 2003, pp. 4.

[387] Oscar Schachter, "The Decline of the nation-State and its Implication for International Law," pp. 16. in Jonathan I. Charney, Donald K. Anton and Mary Allen O'Connell, edit, *Politics, Values and Functions: International Law in the 21st century*, Kluwer Law International, 1997.

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