I. Governance
What Are the Issues?

by Helmut K Anheier

This Report is about the changing conditions of governance, the challenges and opportunities involved, and the implications and recommendations that present themselves to analysts and policymakers. Indeed, few would doubt that the demands put on existing governance systems have changed–and continue to change–as the early twenty-first century seems to enter a period of profound uncertainty. The aftermath of the 2008 financial crisis is a case in point, as is the inability of the international community to reach agreement on major issues such as the environment, freedom of information, or arms trade.

With established systems under pressure, and no realistic, visionary grand solutions to guide, the world is nonetheless alive with a seeming cacophony of approaches–old and new–on how to improve governance and, ultimately, policy outcomes. Not all are well grounded, let alone well guided. Some innovations would likely do more harm than good; others appear unfeasible, too self-serving, or fraught with unknown consequences. Some, however, do harbour potential for seeking better ways and means of governing the world's affairs, be they in terms of economic well-being, justice, financial stability, environmental protection, health or social welfare. They differ in how much actual good they would do; the extent to which they are sustainable and replicable; and, of course, how much legitimacy they do and could enjoy among stakeholders.

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These innovations take place in a complex world with a seemingly contradictory 'push and pull': cautious pooling of national sovereignty is met by attempts to repatriate monetary or environmental policy, with the euro and Rio+20 as cases in point; a greater openness of national borders confronts renewed emphases on safeguarding and policing frontiers, as exemplified by challenges to the Schengen Agreement; the growing volume of cross-border economic activity is threatened by protectionism, especially by emerging market economies; the free flow of information, so much facilitated by the rise of the Internet, faces the controlling hand of governments and private corporations alike; the ACTA Agreement and small arms treaty of 2012 join a growing list of treaty failures that includes the Mutual Agreement on Investments in the 1990s, and the Kyoto Protocol in the 2000s; social and political movements organise more easily across borders as part of a growing global civil society yet face many restrictions at national levels and find limited access in international organisations. Finally, although more examples could easily point to the 'back and forth' of today's world in other policy fields as well, international people movements, while growing in numbers, show increasing travel restrictions and more selective migration patterns.

Governance and Interdependence

These developments occur in the wake of deepening interdependencies among countries. Financial markets, global supply chains, and the Internet are as much indications of this deepening as are environmental issues, migration, health and social policies. Such interdependencies have opened up many opportunities but they also involve risk; they invite competition as well as cooperation–and not only among states but also among business corporations, public agencies, and civil society institutions.

As recent crises have amply demonstrated, risks and opportunities on the one hand and competition and cooperation on the other are more easily realised and established for private goods and services than for public goods generally, and for global public goods in particular. And it is in context of the latter–bringing about policy outcomes that involve cooperation and competition in public goods provision–that governance systems have shown the greatest strains and weaknesses.

Developments towards greater interdependence unfold in the context of major shifts in global power relations since 1989 and a politically weakened and cash-starved UN system. They gather force as many states find their capacity to respond to the developmental challenges of our times reduced, with limited state capacity in all but a very few countries and the persistence of failed states, in contrast to the continued rise of the transnational corporation as the likely dominant organisational form of the twenty-first century and a strengthened role of civil society actors at national and international levels.

We live in a complex, interdependent world, to be sure, so perfectly illustrated by the financial crisis of 2008, especially the tensions between risk and opportunity, and cooperation and conflict: weaknesses in national and international financial regulation created short-term opportunities and long-term risks, brought to extremes in the US housing market. At the height of the tumult, the solution to swap private for public debt pushed sovereign debt to crisis levels for countries such as Greece, putting pressure on interest rates for government bonds and the euro; others, like the US or the UK, through a policy of quantitative easing opted for higher inflation and loss of purchasing power. Austerity measures enacted by national governments to reduce public debt and ensure liquidity led to economic contraction, increased unemployment, and political instability. Ultimately, political and financial risks increased, as did opportunities and opportunism; and institutions meant to cooperate found themselves in conflict, e.g. the European Central Bank and national central banks, and countries until recently on the best of terms traded public insults, at times falling back onto old stereotypes.

It seems that the geopolitical dynamics unleashed by the end of the Cold War, the economic globalisation spurt that has gathered new momentum with the rise of emerging market economies, and the advances in information and communication technologies–all appear to threaten the very foundations of many of the successes they themselves helped bring about over recent decades. In an almost dialectic process that would require the pen of a Joseph Schumpeter or Max Weber to describe adequately, the affairs of the world–at the global and even local level–seem to be going backward and forward at the same time, leaving the observer at awe as to the speed and depth of the changes taking place.

By good governance we mean an effective, efficient, and reliable set of legitimate institutions and actors engaged in a process of dealing with a matter of public concern.

These changes have not gone unnoticed, to be sure, as the uncertainties they generate lead to searches for new approaches to governance and policymaking. This pursuit involves new ways of thinking (e.g., the initiative to redesign economics by the Institute of New Economic Thinking; to rethink the very notion of sovereignty as a foundation of a future EU that is at the core of the various political design efforts proposed by think tanks around Europe), innovations of many kinds (e.g. constitutional reform to break political gridlock in California; social impact bonds in Britain; or Liquid Democracy in cyberspace), and also investigations of how weakened institutions and fragile organisations could be changed to perform better in the longer run (e.g. UN reform efforts, relationship between the European Central Bank, national banks and regulatory agencies, or the African Union).

New approaches are being explored and tested, not only by national governments and international agencies but also by local governments, corporations, think tanks and universities as well as civil society organisations. They reflect specific interests, to be sure, and serve different stakeholders, entangled in strategic games of power relations and positioning–be it in dealing with transnational issues such as the euro crisis, climate change, or intellectual property rights or with seemingly more local issues such as local government budget woes, water and air pollution, or crime.

This Report is not to lament the changes and uncertainties of today's world; nor is it to bemoan the complexity of the often contradictory movements and counter-movements that are taking place; rather the Report seeks to address the implications of the current state of the world in terms of governance–or 'good governance' to be precise. By good governance we mean an effective, efficient, and reliable set of legitimate institutions and actors engaged in a process of dealing with a matter of public concern, be it in the field of financial markets, health care, or migration, and across local, national and international levels.

While achieving good governance may be difficult during the best of times, it is certainly more difficult today–not only because there are more 'actors' involved, be they governments, regulatory agencies, corporations, political parties, or social movements. Furthermore, it is not more difficult only because there are more high risk issues at stake: be they climate change, demographic changes, financial markets, or health care costs. What ultimately lies behind the complex challenge of governance today is the increased interdependence among actors across policy fields and geopolitical borders.

The interdependencies of today's world go beyond governments and corporations but involve civil society and communities–and with these, religions and values.

Interdependence implies constraints as well as opportunities. What corporations have practiced for long is being taken up as explicit policy and a seemingly rational choice by nation states: cooperation when necessary to address matters of common concern; and competition whenever possible in order to secure access to human and natural resources. This implies, as Chapter 2 argues, free-riding, stalling and a zero-sum orientation when approaching international treaties and cooperation generally. One expression of this emerging trend towards intensifying competitiveness and rivalry among states, often together with corporations, is the growing interest in immigration policies aimed at attracting the world's best brains. Another is the use and abuse of copyright regimes by some countries and firms alike; a third, the purchase of vast tracts of African land by Arab and Asian countries to secure food supply; and a fourth, the routing of oil and gas pipelines.

The interdependencies of today's world go beyond governments and corporations but involve civil society and communities–and with these, religions and values. The Danish cartoon crisis of the mid 2000s is a case in point: the public spheres of two regions, i.e. Denmark and then the 'West' on the one hand, and Iran and Afghanistan, later the Islamic world on the other hand, were brought into contact through migrant communities and cyberspace in a conflict over press freedom and religion, causing riots and leaving many dead (Albrow and Anheier 2006). So is the release of a video on the Prophet Mohammed and the fierce and often violent reactions it provoked in many Islamic countries in 2012. What is more, the Arab Spring of 2011 revealed how youth activism in several countries in the region, diaspora communities dispersed across Europe, the Internet and the international media succeeded in creating a public sphere on Tahrir Square and enacted deliberative politics that proved capable of regime change.

Interdependencies also involve goods and bads. That air or water pollution does not stop at political or geographical borders is as much a commonplace as it remains a largely unsolved problem in much of the world. That serious environmental pollution impacts other policy fields like food security, health and migration over time, too, seems a rather obvious statement; but such interdependencies or spillovers from one policy field to another remain easier stated than addressed, and remain frequently unsolved.

How, then, can we make sense of governance in a world that seems to be changing fast, not necessarily always for the better, and that seems to gain in complexity, even a certain 'messiness' und unpredictability as it moves seemingly forward and backward at the same time? What are the main issues and components of, and for, good governance? What governance innovations are taking place, what options emerge, and what policy recommendations come to mind? This is where the Governance Report comes in.

The Report focuses attention on institutional changes and innovations that state and non-state actors have adopted, or could adopt, in response to the structural shifts that have been occurring and are likely to become even more pronounced and entrenched in the future. Put differently, the Report does not deal with the purely technical and procedural aspects of today's policy challenges, e.g. the best technology to reduce greenhouse gases; how to introduce voucher systems in social welfare provision; or how to improve treaty compliance of UN conventions. Rather, it uses such policy challenges as a lens to see how different actor groups have adjusted and could adjust to the new types of challenges brought about by changed and changing governance conditions.

Take one example to illustrate the kind of interdependencies we have in mind: by mid-twentieth century, the extreme pollution of Europe's Rhine River System and damages caused by severe and frequent flooding finally pushed the countries, ministries, regional authorities, municipalities, manufacturers, mining companies, shipping agencies, and nongovernmental organisations into collective action. Any actor on its own would have been incapable of improving water quality and preventing floods; moral hazard, free-riding, fragmented constituencies and patchy regulation required a series of international conventions, especially the 1963 Berne Convention, to reduce water pollution by binding parties together. Today, the International Commission for the Protection of the Rhine, created on the basis of that Convention, is to develop its ecosystem in a sustainable manner; to ensure that river water is apt for drinking water production; to improve the quality of Rhine sediments such that dredged material may be deposited without causing environmental harm; to put in place a holistic flood prevention and protection system taking into account ecological requirements like flood plains rather than dams; and to provide ecological relief for the North Sea.

Turning the Rhine from an ecologically dead shipping canal back to a river with a water quality not seen in perhaps a century and to which many species of fish have returned and now flourish represents a successful example of governance, as would the Great Lakes Commission in North America. Other salient examples of such approaches to governance for achieving policy outcomes are innovations such as: the UNICEF-led project 'A Promise Renewed' to lower child mortality (UNICEF 2012)[1]; public budgeting to create transparency and thereby reduce corruption[2]; the acquis communautaire in the 1990s to regulate accession to EU by central and eastern European countries[3]; new ways of allocating risks and rewards in social markets (see social impact bonds in Chapter 4); approaches to public-private partnerships in addressing public healthcare problems[4]; forms of e-governance to improve citizen access to services and to offer greater voice (see, e.g. mySociety also reviewed in Chapter 4); ways and means of handling internal and external conflicts, including their legacy, as exemplified by the South African Truth Commission or the International Criminal Court in dealing with war crimes[5].

Why Governance?

Governance is a fairly new concept that has gained much currency in recent years.[6] Governance is a broader notion than government and its principal elements of legislature, executive and judiciary. The World Bank (1991) defines governance as the manner in which power is exercised in the management of a country's economic and social resources for development. Note the emphasis on power and management and the nation-state frame. The corporate governance perspective, in a similar way, views governance as a way of distributing rights and obligations among boards, managers, shareholders, unions and other stakeholders. We suggest that neither the power-based nor the rights and obligations approaches, and clearly no longer the nation-state framework alone, are sufficient to capture the complexity of modern governance.

By contrast, Enderlein et al. (2010: 2) suggest a generic definition of governance that denotes 'the sum of rules and regulations ..., processes as well as structures... justified with reference to a public problem' brought about by actors. In other words, governance is about how we approach and solve a recognised collective issue or problem such as public security, poverty or pollution; how we monitor the performance of corporations; and the role of civil society.

Kooiman and Jentoft (2009) distinguish between first and second order governance. The first is about deciding who can legitimately address what public problem for whom and how; and the second about the kinds of institutions, organisations and regulations needed for achieving desired policy outcomes. First order governance is more about politics; second order governance more about policies. However, first order governance is not necessarily a top-down approach, nor does it always come first. Frequently, the identification and framing of public problems are brought forward from below, from social movements and civil society institutions. The interaction of from-below activity with top-down legislation through parliaments or legitimated agencies brings about first order governance proposals.

But what do these rather abstract terms actually mean? Let's consider a hypothetical case first, and then look at a series of 'real' governance arrangements to begin to appreciate today's governance challenges and potentials.

Imagine a group of some 200 cruise ship passengers stranded on an isolated island. They vary by age, gender, education, occupation, and wealth. While most are able-bodied adults, there are a few children and frail-elderly among them. They managed to rescue food and medical supplies estimated to last three months and succeeded in obtaining basic tools for constructing shelter from the sinking ship. A source of fresh water supply was located, though its reliability is unknown. For some reason, and in the fog of frantic rescue efforts, some 100 cases of champagne and 10,000 packs of cigarettes were also uploaded and made it to the island's shore.

The stranded passenger case, familiar to generations of governance students, leads directly to the heart of what governance is about: how to govern what, for what, by or through whom, and according to what rules? This is the first order governance problem. How is the power to make decisions to be distributed in terms of rights and obligations? Should elections be held? Should all adults have equal vote, or should those most knowledgeable and able to function have more influence? Then follow second order issues: should all receive equal portions of food? Who is to oversee the process of dividing and disbursing rations? How should we distribute medicines, and on what basis? Should trade be allowed so the ample but capped supply of cigarettes could serve as currency? Should those building shelter for others or those helping the injured be rewarded and enjoy privileges such as the conspicuous consumption of champagne?

Table 1.1 **Governance orders and dimensions**

Governance Order	**Dimension**	**Basic Questions**	**Main Tasks**
First Order 'Politics'	Legitimacy	Who?	Power basis, allocation of rights and responsibilities
	Public Problem	What?	Definition, framing formulation
Second Order 'Policies'	Institutions and organisations	How?	Setting rules, designing, implementing
	Regulation and control	What if?	Monitoring, sanctioning, incentivising
Policy Outcome	Performance	So what?	Goal attainment, distributional effects

In raising these questions, we implicitly address five distinct but related dimensions of governance (Table 1.1). First order governance is essentially about power and politics in the large sense as the interplay between the exercise of legitimate power and its support endowed by stakeholders, i.e. the extent to which a distribution of power and its rights and obligations obligations entailed are seen as legitimate. Who among the passengers has the right to assume power, how and why? Is power limited and checked? Is it established and maintained by threat of violence or given freely? First order governance is also about the issues at hand and the public problem that needs defining and framing–the other dimension. Is the use of cigarettes a public problem, one with the same priority as looking into water supply or medical care? Defining and framing are closely related to solving or at least suggest approaches on how to address the public problem.

Second order governance, too, includes two dimensions: first, what rules and regulations are needed, and, second, how are we to enact them? For example, should there be markets, hierarchies, or networks based on communal or family bonds when distributing food? Then there are issues about the regulations themselves, ways of monitoring them, the checks and balances needed to make sure that rules are observed, and, if violations occur, that sanctions can be applied, and redress and remedial action sought.

The final dimension is the outcome achieved by first and second order governance arrangements. It is about performance and achievement, and the extent to which the governance system in place has brought a solution, obtained a desired level of goal attainment and brought about intended redistribution outcomes, and, especially, the extent to which it enjoys the legitimacy among key stakeholders.[7]

Let's now look at some real-life governance cases, and begin with a rather mundane, seemingly trivial example: the hamburger, a near universal fast food item consumed by millions of people across the world each day. While a private good, it is also public in a profound sense from a governance perspective. Yet what precisely is the governance problem when it comes to hamburgers, and how is it governed?

Box 1.1 **Governing the Burger**

Behind every hamburger ordered as a meal for lunch is a process surrounding a complex set of rules and regulations that involves various agencies and organisations. Normally we do not think about this process at all, taking for granted that somehow consuming a hamburger in a fast food restaurant is as predictable as it is mundane and, presumably, safe. Yet how exactly is the burger governed as it is transformed from cattle on a ranch to patty on a plate?

Working backward through the production cycle, store policies would be the first aspect of regulation from storing, thawing and preparing the meat patty to how it is to be assembled into a hamburger, dressed and presented. Some of these policies are the rules of the fast food franchise while others are a matter of public governance, highlighting the public problem: hygiene and food safety.

Hamburger franchises cannot treat food in any way they like. They must adhere to certain standards of public hygiene. Accordingly, the store policies fall under the jurisdiction of food hygiene regulation—usually a municipal or state-level agency, which in turn is overseen by a national ministry or agency of agriculture. In Los Angeles, California, for example, food safety is monitored by an inspection agency run by Los Angeles County, which maintains several bureaus dealing in environmental matters that oversee regulations and maintain a restaurant rating list based on hygiene. In Germany, regulation is lodged with the Business Control Service (itself part of the state police). It randomly checks food stores and reports to the Federal Ministry of Food, Agriculture, and Consumer Protection.

However, if we assume that the franchise happens to be located in the European Union, there are also EU norms, which in turn provide a common framework for national food hygiene regulation and are administered by the EU's Directorate General for Health and Consumers. In addition, there is the global 'Codex Alimentarius' jointly overseen by the UN's Food and Agriculture Organisation and the World Health Organisation and to which EU, national and local regulations are to conform. Some of these regulations address meat marketing, transportation and, indeed, meat processing, and others the slaughtering of animals, the raising and breeding of cattle, and the food they consume. Ultimately, we will reach the germ cell that grew into the cow that provided the meat that eventually became the burger patty served on your plate.

The many rules and regulations around meat production are the result of long and bitter struggles not only between and within agencies, ministries, European institutions or even UN organisations, but also between producers, consumer protection organisations, and animal rights activists who clashed in the context of routine politics as well as in response to large-scale crises and scandals. So when looking at it from this angle, a simple burger patty thus aptly illustrates the enormous complexity of governance—regarding the multitude of institutions involved on various political levels as well as the numerous actors engaged in pressing for, passing, implementing, and enforcing the respective rules. The simple patty on your plate thus actually is the highly multi-level, multi-actor outcome of a complex process of governance.

by GREGOR WALTER-DROP

The core public problem in hamburger governance (see Box 1.1) is food safety along the production process of the main ingredients: meat, wheat, vegetables, and condiments. It involves local (e.g., food inspection agency), national (e.g., health authorities) and international agencies (e.g., EU and UN conventions), as well as corporate (e.g., restaurant) and civil society (e.g., consumer advocate organisation) actors. So when sitting down to appreciate a hamburger, we have, in fact, a multitude of institutions and organisations looking over our shoulder, and whose combined regulations and pressures made sure that the product–while not among the healthiest–is at least safe to consume.

The hamburger governance system evolved over time and is the result of failures (e.g., lack of hygiene and food poisoning) and ways to avoid them (e.g., food safety inspections); it involved many conflicts (e.g., meat producers vs. animal rights groups) that would have impacted franchises and their profits; and it meant calibrating corporate strategies with consumer preferences and public health demands for better nutrition. It continues to evolve as new issues such as obesity or genetically modified food come up and push against established interests.

That governance is the result of ongoing contests of political as well as economic power and interests becomes even clearer when taking a brief look at how the financial system is governed. Indeed, fiscal and financial governance is the thematic focus of this year's Report, as is, in the context of the 2008 financial crisis, the politics of global finance. That rules and institutions governing international markets have not kept pace with these rapid and substantial changes is clear even to the most ardent proponents of nation-state centred financial policy that seek to keep as much financial regulation as possible at the domestic level. The world is entering the fifth decade of the post-Bretton Woods era, which began in 1973, without a formal and functioning international monetary system in place.

As Chapter 3 makes clear, the current system of international financial regulation has not been lacking in complexity given the multitude of international organisations, statutes, committees, and agreements (Davies 2010). Besides the IMF and World Bank, roughly 20 organisations such as the Financial Stability Board, FATF, IAASB, Bank of International Settlements, Basel I to III, and IOSCO make for an interconnected web of regulatory responsibilities that is, even for the expert, hard to disentangle (highlighted through the purposeful use of acronyms).

Moreover, representation in these institutions has been heavily skewed toward Western countries in general and the United States in particular, which, in turn, has continued to pursue a primarily national economic policy through them. In addition, Europe may have arrived at a common currency but still lacks a common voice in the form of political-fiscal governance. The absence of an effective, international and comprehensive governance structure can be mainly attributed to the lacking willingness of national governments to transfer competencies from the national to the supranational level.

After the 2008 crisis, the reaction was to increase regulation, which in most instances meant greater reporting requirements imposed by national bodies. So far, proposals to reform the global financial architecture have

Box 1.2 **Governing the Budget in California**

As the California Department of Finance states: 'The budget process for California defies a simple concise definition. It is a process rather than a product' (http://www.dof.ca.gov/fisa/bag/process.htm). In terms of governance, it exemplifies how two of the most essential functions of government, taxing and spending, can be effectively halted by institutional constraints and spill-ins through voter interventions or global trends such as financial and economic crises. It also illustrates how established governance structures and processes can be trapped in a vicious circle of ineffectiveness, which undermines the efficacy and, ultimately, the legitimacy of governance.

At first glance, the process to pass the state budget in California is straightforward and follows a model embraced at all levels of the US government. The state's governor, as the elected chief executive officer, proposes a budget, which is introduced at a press conference with the governor highlighting special policy initiatives and the budget's overall principles. It is then promoted in the State of the State Address before being introduced in each chamber of the legislature. The governor's budget must be accompanied by a budget bill, itemising recommended expenditures. The Assembly and the Senate take up the budget bill and divide the sections among subcommittees, which report back to the Assembly Budget Committee and the Senate Budget and Fiscal Review Committee, which submit a recommendation to the respective chambers.

However, the final threshold for passing a budget is high. Since Proposition 58 was approved by California voters in 2004, the state has to pass a balanced budget each year and cannot finance its expenditures by taking on additional debt. Six years later, voters supported Proposition 25, allowing the legislature to pass the budget with a simple majority in both chambers—instead of the previous two-thirds majority. However, a two-thirds majority is still required to raise new revenues. Given that neither party is usually in control of such a majority in both chambers at any time, political majorities are almost impossible to organise for any increase in revenue.

California allows its citizens via direct initiative to propose and vote on constitutional amendments and laws, which is why California voters are frequently asked to vote on new taxes or tax increases at the ballot box whenever revenue increases are blocked or rejected in the legislature. Given the balanced budget requirement and California's burden of public debt, voters decide whether to increase taxes or face drastic spending cuts.

Unlike any legislature, the decision-makers in this case—the voters—are not required to engage in deliberation or compromise; they can only approve or reject propositions. With little technical knowledge of the complex budget measures before them and a barrage of special interest advertisement on the advent of the vote, citizens have to decide with little or distorted information. Their decisions impact directly the fate of teachers, firemen and street cleaners, as well as state programmes, such as for culture and the arts.

Each drastic spending cut that follows a failed proposal for a revenue increase to balance the budget further withdraws the means from local government to achieve good performance. Hence, while the California budget is governed on the local level, it is subject to external effects such as economic trends (e.g. the financial crisis and recession of 2008 and 2009) or the influx of special interest money to be spent on political advertisement. The governance structure in place lacks the appropriate mechanisms to achieve effective, efficient and legitimate decision making because it rewards political stalemate instead of providing incentives for deliberation and compromise.

aimed at establishing new agreements, statutes and committees but without either putting in place some new institutional framework or rationalising the existing ones to accommodate altered macroeconomic conditions. Indeed, there is confusion between first and second order governance decisions, and a consequent emphasis on technical fixes, as Chapter 3 argues.

Do financial matters look simpler at local or regional levels? Let's take fiscal governance in the US state of California as an example, and look at how the state's budget comes about (Box 1.2). Here, clearly delineated first order governance decisions are caught in spill-ins through the electoral process, namely the frequent use of referenda and propositions. The California budget is less about the budget and what the state requires in terms of public spending given its growing population; at its core, it is about taxes, and especially the politically willed enshrinement to limit and reduce direct taxation on income and wealth. It is an example of a governance system caught in a suboptimal political stalemate created by past policies and electoral outcomes, which leaves little room for manoeuvre for actual fiscal governance. As a result, second order governance is blocked.

Yet the California budget is not a California problem. First, as the world's seventh largest economy and centre of high technology innovation, it is connected to all corners of the globe, and a systemic failure of its public sector will have repercussions well beyond its borders and the US. Second, California debt is financed by the international bond market, and closely watched by rating agencies. In other words, California matters to the world just as the eurozone does; they are interdependent yet appear to be seemingly disconnected policy actors.

Could it be that we do better at governing newer domains like the Internet (Box 1.3) than entrenched budgetary problems? Here, too, we see

Box 1.3 **Governing the Internet**

> 'Internet governance is the development and application by governments, the private sector and civil society, in their respective roles, of shared principles, norms, rules, decision-making procedures, and programmes that shape the evolution and use of the Internet'.
> *Tunis Agenda for the Information Society, 2005*

The Internet is a globally distributed network where information is decentrally stored on and communicated between interconnected computers. Its operation requires the smooth functioning and interaction of many layers, including physical infrastructure, codes, and content, and involves, among others, service providers, engineers, developers, and ultimately users.

A look at just one layer illustrates the complexity of Internet governance. When you enter 'www.hertie-school.org' as a URL (Unified Resource Locator) in your web browser, it is translated into an IP (Internet Protocol) address, or '212.77.229.145' in this case. The IP address is what your browser and your computer need to connect to another computer on the Internet and retrieve the requested information. Since such numerical IP addresses are not easy to remember, URLs like 'www.hertie-school.org' are used to make Internet navigation easier.

Valid URLs must comply with the Domain Naming System (DNS), which is at the heart of how the Internet appears to the everyday user. Allowing or not allowing Top Level Domains (TLDs) such as '.org' (for organisations, originally intended for non-profit ones), '.com' (commercial), or '.xxx' (adult entertainment) can make a big economic, political and moral difference.

The DNS and other essential technological and policy aspects of the Internet infrastructure are coordinated by the Internet Corporation for Assigned Names and Numbers (ICANN), a nonprofit, private organisation based in the United States. Essentially, ICANN allocates and maintains the unique identifiers that allow computers on the Internet to find one another. While, generally speaking, the Internet operates without a central governing body, the power over the DNS makes ICANN in fact one of very few authorities with global, centralised influence over the Internet (Mueller 2010).

ICANN is itself a complex entity with three supporting organisations, four advisory committees, a technical liaison group, and its international governing board contributing to decision-making. Among the advisory groups are the Governmental Advisory Committee, on which national governments and international treaty organisations are represented, and the 'At-Large' Advisory Committee representing normal everyday users. While final decisions on any changes are made by ICANN's Board of Directors, they come after a consensus-building process involving, in particular, the supporting organisations and advisory committees, as well as the general public.

ICANN's position in Internet governance is not uncontested. ICANN's operations were governed in large part by Memorandums of Understanding with the US Department of Commerce until 2009, when an 'affirmation of commitment' replaced the expired project agreement (MacKinnon 2012). Despite this change in overt control and efforts on ICANN's part to enhance transparency and participation, many voices—especially IBSA (India, Brazil, South Africa)—have called on the UN to create a new body to oversee the technical and operational functioning of the Internet and to arbitrate disputes. The governance questions at the moment for this layer of the Internet are whether it should continue to be the remit of a transnational, private-sector led entity or of nation states and intergovernmental organisations and whether the US should maintain its privileged position through control of the DNS and IP addresses.

by BJÖRN NIEHAVES

a complexity developing that suggests unclear boundaries between first and second order responsibilities. How about the governance of fields like maritime and oceans policy? While ages-old, this field requires urgent attention due to pollution, rising sea levels, depleting fish stocks, and the prom-

Box 1.4 **Governing Oceans**

While oceans are areas devoid of statehood, they are by no means 'un-governed.' States may only claim authority over the ocean and the seabed within the twelve nautical miles (22 kilometres) of territorial waters. Beyond these territorial waters, states' powers become more limited: a coastal nation's sole exploitation rights over natural resources (e.g., minerals, oil and fish) extend 200 nautical miles (370 kilometres) from the baseline to form exclusive economic zones. Beyond these boundaries, multiple stakeholders assert claims over the ocean: Multinational corporations seek free and safe passage to transport goods and raw materials, as do the economies and consumers who demand them; local fishers and industrial fishing vessels struggle over fishing grounds; and global environmental activists seek to protect endangered ecosystems.

First order governance principles defining the rights and responsibilities of states are laid down in the United Nations Convention on the Law of the Sea (UNCLOS), which was signed in 1982 and entered into force in 1994. Among the Convention's main achievements are agreements on the areas of state authority, rights to resource exploitation, free passage, and obligations for safeguarding the marine environment. However, as continuing disputes over the reach of territorial waters and the continental shelf show, second order governance is crucial to enforcing the Law of the Sea. While the UN has no direct implementation role, the Convention establishes three UN bodies: the International Tribunal for the Law of the Sea to adjudicate disputes; the International Seabed Authority to control resource exploitation of the seabed; and the Commission on the Limits of the Continental Shelf to advise states in establishing limits. Other UN specialised agencies such as the UN Development Programme, UN Environment Programme and UNESCO are involved in addressing, but not regulating, specific governance challenges such as sustainable fishery, pollution and maritime livelihoods. In the European Union, the Commission's Directorate-General for Maritime Affairs and Fisheries oversees development and implementation of the common fisheries policy and the integrated maritime policy.

Other stakeholders engage in a variety of ways to influence and promote better governance of the ocean 'commons'. Nongovernmental organisations such as Conservation International and the World Wildlife Fund (WWF) are forming broad partnerships with governments and businesses to conduct research, educate the public, and develop new ways to manage marine ecosystems. On the side of business, many members of ocean industries are engaged in the World Ocean Council (WOC), an association aiming to stimulate 'corporate ocean responsibility' through research, education, and innovation. For its part, the Marine Stewardship Council, an independent NGO originally founded by WWF and Unilever, seeks to set and implement standards for sustainable fishery through product certification and education.

While the oceans have been governed by customary law for centuries and are nowadays subject to the Convention on the Law of the Sea, multiple actors must be involved to ensure the implementation of its principles. While the UN bodies established by the Convention have the power to advise and adjudicate the disputes of member states, it takes initiatives and actions of other governmental, civil society and business actors as well to hold stakeholders accountable for their actions and foster ideas for promoting ocean health as a global public good.

ise of raw materials (Box 1.4). Both ocean and Internet governance have the added challenge of managing both the protection of global commons and private commercial use, bringing into focus issues such as property rights and global public goods.

Chapter 2 of this Report revisits the management of interdependencies from a global public goods perspective, and clarifies how those involved in public policymaking nationally and internationally within the realm of the state, the market and civil society could resolve and properly balance risks and opportunities as well as cooperation and competition. Doubtlessly each of these strategies has its place. But it could be destabilising if competition–going it alone, if necessary, by using one's economic or military might–were chosen where international cooperation would be the preferable option for all. In fact, national and private interests can often be best achieved through cooperation–management of spillover effects; seeking policy buy-in of others; and, importantly, more participatory governance. Likewise, deterrence, coercion and exercise of power may have their place in addressing interdependencies, but the shadow of authority, strategic coalition building and trust building measures towards workable solutions may be more optimal in the end.

The Report does not start from a normative perspective. It recognises that we live in a world of diverse and differing policy priorities based on different normative foundations and deep-seated value dispositions that lend themselves to different interpretations of concepts such as democracy, human rights, justice and equity. Recognising such differences, the Report explores which policy thinking and rationales and organisational arrangements have emerged in response to today's changing realities; which seem to hold promise in different contexts; and what lessons can be drawn from these experiences that could help particular actor groups realise their policy goals while fostering global stability, growth and sustainability.

Governance Performance

The examples in the text boxes–and with greater analytic depth in Chapter 2 as a whole–show that governance is rarely some simple command-type structure where the exercise of power leads to predictable actions to achieve some desired outcome. It is not about some direct input-output relationship addressing well-defined and contained public problems. This may work in limited circumstances, but is in no way characteristic of contemporary governance challenges. Even the hamburger example revealed the interplay between different actors and the connections between policy fields.

Rather, governance includes multiple actors or stakeholders, multiple levels and policy fields, frequently contested problem frames and definitions. There are spill-ins and spill-outs across levels, actors and fields–the result of the interdependencies characteristic of a globalising world which is also evident at more local levels. In sum, governance is a system of related, nested parts whose interdependence in political, legal and economic terms implies shared scope of autonomy and responsibility. For some actors like governments, this addresses notions of sovereignty, as Chapter 2 discusses, and for others, degrees of independence and hierarchy. It is these kinds of systems that are of central interest to this Report.

How then are we to understand the performance of such systems in terms of good governance? What first and second order arrangements and ways of managing interdependencies bring about the effective, efficient, and reliable set of legitimate institutions and organisations dedicated to dealing with a matter of public concern? For this purpose, the Report adopts a conceptual model first introduced by Linz and Stepan (1978) to study the performance and stability of political regimes. While they looked at regime performance over time, the model proposed here (Figure 1.1), would look at governance systems and distinguish between:

- ***Legitimacy*** involves two mutually reinforcing components: it requires adherence to the institutional rules and regulations by both the majority of actors and those in position of authority based on first order allocations of responsibilities, rights and obligations; and it requires trust on the part of those affected to uphold these rules and regulations. For example, we expect the eurozone countries to uphold the Stability Pact, and their populations to have confidence in the ability of their governments to do so; just as the legitimacy of a local school board depends on its proper discharge of duties and the confidence of teachers, parents and students in the organisation.
- ***Efficacy*** is the capacity of those in power and leadership positions in the relevant organisations and regulatory agencies of governance systems to find solutions to the public problems identified, both strategically as well as in the short to medium term. In this sense, we expect the eurozone governments and central banks to find a solution to the euro

crisis, just as the efficacy of the California legislature rests on finding a proposal for a balanced budget by not raising direct taxes.

- ***Effectiveness*** is the capacity of those charged with second order governance to implement the strategies, policies and measures formulated, and with legitimate means yielding desired results. For example, even if the California Senate finds a proposal to balance the budget and not raise direct taxes, can the administration actually implement the plan, and deliver on its promise in efficient and effective ways without violating some other laws or agreements? Can proposals to safeguard the oceans that most actors regard as efficacious actually be implemented efficiently to yield effective results?
- ***Performance*** is the 'dependent variable' in terms of good governance, defined as the capacity of the governance system to meet set goals, or at least attain a level of performance seen as satisfactory by key stakeholders to maintain stability over time. Bad governance, in turn, would be systems that underperform and reveal instabilities.

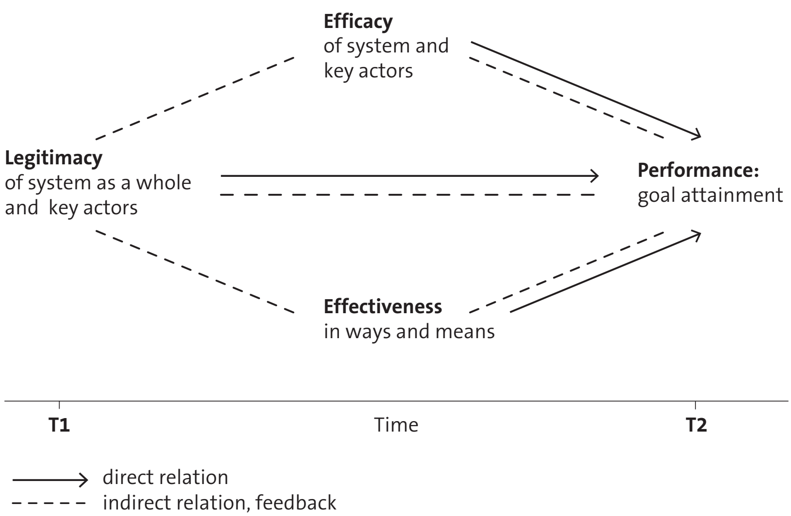

Figure 1.1 **A model of governance performance**

Thus, the performance of a governance system depends on three crucial aspects and their interrelationships: legitimacy (are trusted actors playing by the rules, and is the system as a whole to be trusted?), efficacy (do they know what they are doing?), and effectiveness (do they achieve acceptable results with reasonable means?). The legitimacy of the governance system in place becomes a positive and negative reinforcer that magnifies the effects of efficacy and effectiveness on performance and vice versa. Governance becomes a process[8].

Indeed, as Chapter 3 argues for financial regulation, ill-performing governance systems are unable to solve trade-offs that then affect the legitimacy of key actors, their plans and performance. Inabilities to address trade-offs such as liquidity vs. moral hazard or accountability vs. effectiveness cause financial governance systems to enter a downward spiral that can only be halted and potentially solved politically as first order decisions rather than through technical fixes to improve efficacy.

Chapter 2 introduces the notion of governance readiness, defined as the degree to which intended policy outcomes are actually achieved. It offers a complementary view to the model proposed in Figure 2 above, and addresses a number of key dimensions that refer to i) the improvements or modifications of existing governance systems; and ii) the incremental and more fundamental innovations needed when incompatibilities arise. Activities to improve and modify governance systems are frequent, yet fall short of meeting requirements once conditions change in more profound ways. The latter are rarer, yet of a more fundamental nature as they require thinking beyond the status quo and may involve greater uncertainty. In other words, good governance demands not only performance of a given system to secure legitimacy, but also the anticipation of, and reaction to, changing conditions.

Innovation

How, then, does good governance come about and how is it maintained? How can an overall fit between the functioning of governance systems and the governance requirements of policy fields be achieved and maintained? Governance systems are rarely designed from first principles and from some kind of tabula rasa; rather, they evolve from existing systems and through creative tensions between governance requirements, performance and legitimacy (Figure 1.1).

As explained in greater depth in Chapter 4, there are two perspectives on how such evolution occurs: one emphasising the discontinuous (Christensen 1997), the other the continuous process of governance innovation (Moore 2005). In the first view, governance systems are assumed to pass through relatively long periods of stability, building up inertia and thereby reducing their fitness over time. Unexpected bursts of fundamental changes are then triggered in response to threats, uncertainty, or crisis. The second perspective emphasises gradual changes in governance systems. In this view, new elements are introduced into an existing governance system (recombination), or a governance system relocates or expands into new contexts, policy fields or jurisdictions (refunctionality). Together, the two processes shape the system's evolution as they improve efficacy and effectiveness, with positive impacts on performance and legitimacy.

Clearly, both perspectives are useful for understanding governance changes, and the processes they imply are rarely mutually exclusive. Punctuated equilibriums and more gradual developments can be present at the same time, and indeed the former can create opportunities for the latter: the change in global power relations set in motion after 1989, the rise of the emerging markets, similar epochal events like climate change or the Internet will take time to sort themselves out, not in the least because they imply serious challenges to conventional notions of national sovereignty. Hence, design innovations and policy reforms are dearly needed.

In this Report we describe and even suggest a number of governance innovations that reflect both of these perspectives and touch on many levels, actors and policy fields. In general, these innovations suggest that there are no larger ideologies or visions of and for governance being developed–let alone debated–that in scale and ambition rival the organising and mobilising power of neo-liberalism or social democracy (Judt 2010). They are about making systems more efficacious and effective, and they are not about some new overall attack on root causes of some systemic ill or another. This finding resonates with Chapter 2, and the finding that governments are better at maintaining and improving often entrenched governance systems, even if they are increasingly incompatible with governance requirements, than pursuing more fundamental reforms, especially at the global level.

Indicators

The conceptual frameworks for governance performance and readiness presented in this Report serve one important function: they help identify the kinds of indicators and information needed to measure how well governance systems perform, and how ready they are to meet today's and future challenges. While attempts to quantify governance have grown in scale and scope, they tend to focus on the administrative capacity and efficiency as well as ills such as corruption or regulatory failures, and have addressed at most indirectly policy outcomes and the overall fit between governance requirements and the systems in place.

This, however, is what this Report attempts to do: lay the foundations for a conceptually grounded system of governance indicators that can be developed over time. As Chapter 5 will present in more detail, such a system measures indicators for three essential components: governance readiness in relation to governance requirements to gauge the gap between what is in place currently and what would be required given current and future governance conditions; governance performance in relation to policy outcomes and welfare effects, as seen in the interplay between legitimacy, efficacy and effectiveness; and innovativeness to assess the degree to which actors generate new ideas and approaches for governance.

Conclusion

As noted at the outset, this Report is about the state of governance today, with its changing conditions. It represents the analysis of a team of interdisciplinary experts assembled by the Hertie School of Governance, with each chapter examining governance challenges, opportunities and solutions at different levels and from different perspectives.

The next chapter explores the question of why we are today facing an apparently lengthening list of global challenges and why many of these challenges remain unresolved although they entail high costs, including, in some cases, potentially disastrous and irreversible consequences. The starting hypothesis is that the reason for today's crisis-proneness–or, put differently, today's apparent governance un-readiness–is that: (1) the present governance systems, nationally and internationally, are not geared to address such challenges; and (2) the required governance reform steps lack political support. The chapter tests this conjecture in three steps. First, it examines today's global challenges through the analytical lens of global public goods in order to better understand the types of governance requirements they pose. Second, the chapter scans various global policy fields in order to spot the types of policy responses with which global challenges have been met and whether these match, or deviate from, the identified governance requirements. In a third step, the chapter suggests factors that could help explain the observed response pattern.

Chapter 3 is about financial and fiscal governance–the governance challenge in focus for this Governance Report. The first part considers the politics of global finance and presents a series of trade-offs that confront policymakers when they think about the design of global financial governance–liquidity vs. moral hazard, accountability vs. effectiveness, and domestic politics vs. international commitments. To make these trade-offs concrete and to consider the practical issues of supranational institution-building and supranational cooperation, the next section discusses the evolution of financial regulation in Europe. The final section then thinks about how capital flow imbalances are part of more general macroeconomic imbalances, and it considers the politics of adjustment in both surplus countries (like Germany) and deficit countries (like Greece).

Chapter 4 offers conceptual guidance for understanding governance innovation. It then presents a set of governance innovations, describing the governance challenge that is addressed, how it is addressed, and the mechanisms affecting the innovation's potential success in fostering significant improvements. This section will remain an integral part of future editions of the Governance Report. Over time, it aims to become a central repository that not only features contemporary examples of governance innovation, but also keeps track of and evaluates the progress of previously presented innovations.

Chapter 5 on governance indicators reflects the multi-level and multi-actor approach to governance that the Report adopts, and presents the initial contours of a future three-pronged indicator system with three components: readiness, performance, and innovativeness. In a second step, the chapter presents select sets of indicators to explore and indeed underscore the usefulness and feasibility of such an indicator system.

A concluding chapter presents the major implications that follow from the Report and spells out concrete policy recommendations, addressing them, to the extent possible, to specific actors and decision makers.

The Governance Report 2013 is the first in a series of annual reports. Future editions will both present new analyses and track the development of the challenges, innovations and data presented here, and especially, review the fate of the recommendations made.

Endnotes

1 http://www.apromiserenewed.org

2 On public budgeting in Brazil, for example, see Bräutigam (2004) and Wood and Murray (2007).

3 A good overview of the acquis can be found at: http://ec.europa.eu/enlargement/enlargement_process/accession_process/how_does_a_country_join_the_eu/negotiations_croatia_turkey/index_en.htm.

4 For example, the Health Impact Fund (http://healthimpactfund.org/).

5 See the websites of the Truth Commission (http://www.truthcommission.org/) and the International Criminal Court (http://www.icc-cpi.int/). See also Glasius (2006).

6 See Scharpf (1999), Zürn (1998, 2000), Worldwide Governance Indicators (http://info.worldbank.org/governance/wgi/index.asp), as well as the Bertelsmann Foundation's Sustainable Governance Indicators (http://www.sgi-network.org/).

7 The field of governance indicators, reviewed in Chapter 5 of this Report, is essentially about how to link first and second order governance characteristics to output and outcome performance, and, ultimately legitimacy.

8 The governance performance model based on Linz and Stepan's original approach serves as a conceptual framework primarily against which to examine the role of actors across policy fields and levels, and to guide the selection and development of governance indicators (see Chapter 5). The model incorporates approaches that distinguish between input legitimacy (modes of political participation by those affected by certain policies), output legitimacy (problem-solving capacity and impact of policies) and throughput legitimacy (procedural fairness and accountability). It goes beyond conventional input-output thinking by emphasising feedback loops and over-time performance in achieving results and maintaining stability.