

The Governance Report 2013

Overview

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Governance is about how well those who are legitimately entrusted to do so manage public problems: Does the international community make progress in regulating financial markets or combatting poverty? Does the EU succeed in reducing sovereign debt problems? Do national and local governments respond adequately to public debt? Do corporate leaders manage businesses in economically and socially responsible ways? And does civil society contribute to public problem solving? A system of good governance is one that deals with these and other matters of public concern—be they education or health care, national security or infrastructure policies, the environment or labour markets—in effective, efficient ways.

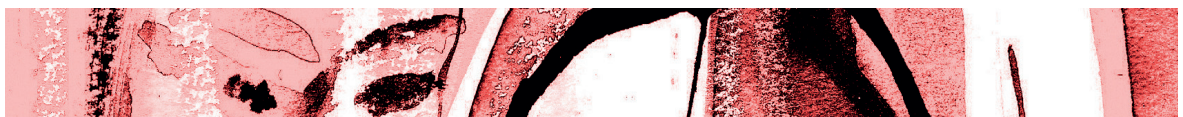
The Governance Report is about the changing conditions of governance, the challenges and opportunities involved, and the implications and recommendations that present themselves to analysts and policymakers in terms of good governance—and with an emphasis on managing interdependencies among countries.

Clearly, 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 2007–8 financial crisis—a focal issue of the 2013 Report—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 on how to improve governance and, ultimately, policy outcomes. While not all innovations are well grounded, let alone well guided, some do harbour potential for seeking better ways and means of governing the world's affairs.

The Governance Report 2013, prepared by a team of experts associated with the Hertie School of Governance, is the first in a series of annual reports, each highlighting particular governance challenges. Future editions will both present new analyses and track the development of the policy fields, innovations and data presented here.

The Report recognises that we live in a world of diverse policy priorities based on deep-seated value dispositions that invite different interpretations of concepts such as democracy, human rights, justice and equity. Recognising such differences, the Report explores which policy approaches 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 for realising policy goals.

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The Challenge of Interdependence

As Helmut Anheier observes in the Report's opening chapter, the changing conditions of governance occur in the wake of growing and deepening interdependencies among countries. Financial markets, global supply chains, and the Internet are as much indications of this deepening as are environmental issues, migration, and issues of health and social policies. Such interdependencies have opened up many opportunities but they also involve risk; they invite competition and cooperation as well as free-riding and domineering— and not only among states but also among business corporations, public agencies, and civil society institutions.

For governments in particular the scale and scope of interdependence means that conventional notions of sovereignty are fast becoming obsolete: They are often based on zero-sum thinking in terms of national interest when positive-sum policies are called for, and they assume an independence where countries are part of a dense and complex web of connections with others.

In her chapter Inge Kaul expands the notion of interdependence in relation to the provision of global goods and introduces six central requirements for the effective management of global problems.

Kaul's Six Key Requirements for Global Governance

GR1: Averting the risk of dual (market and state) failure	GR4: Promoting issue-focus and result-orientation
GR2: Correcting fairness deficits	GR5: Recognising and promoting synergies
GR3: Strengthened externality management	GR6: Active acceptance of policy inter-dependence

Building on her insights, other chapters in the Report suggest potential application of Kaul's governance framework to national and local levels and different policy fields:

- **GR1: Averting the risk of dual (market and state) failure.** Measures must be put in place to discourage the free-riding and profiteering of governments, corporations and other actors and encourage their willingness to cooperate. For international financial markets that have long escaped the reach of national governments, but also in the field of environment and energy, this might include compliance monitoring systems equipped with adequate sanctions. Transparency in such agreements, also at other levels, would help stakeholders and watchdogs understand what is expected of each party and who is keeping commitments.
- **GR2: Correcting fairness deficits.** Proper incentives and sanctions must be created to ensure that all stakeholders are genuinely motivated to support, and act on, what was jointly decided. This requires clear rules of participation as well as burden-sharing, also in terms of taxation and subsidy regimes, which are implemented fairly and transparently, and goals that can be supported by strengthening regional collaboration among states and major private actors.
- **GR3: Strengthened externality management.** Governments and other actors must be more watchful about the effects that their policy actions and their consumption and production

Governance includes multiple actors or stakeholders positioned across multiple levels and policy fields that frequently operate with contested problem definitions and diverse objectives and action frames. There are spill-ins and spill-outs across levels, actors and fields—the result of the interdependencies characteristic of a globalising world, also evident at more local levels. The way we manage the world's oceans, the global financial system, energy and water supply, epidemics or the internet are cases in point.

choices have on others. This is so not only at the nation-state level, but also within corporations, along the lines of social responsibility strategies and reporting that take into account suppliers' actions, environmental as well as social impact, and other externalities.

- **GR4: Promoting issue-focus and result-orientation.** Issue focus is essential for ensuring that all required inputs and processes fall in place. This includes the 'modernisation' of the entire executive branches of governments and their administration to enable them to act across borders. At the same time, result-orientation must be strengthened through a variety of mechanisms, e.g. pay-for-performance contracts in expenditure policies and new procurement approaches to investments for public goods and infrastructure.
- **GR5: Recognising and promoting synergies.** Synergies among problems and their solutions must be recognised and promoted, requiring strategic leadership that spots early warning signals. Here is where civil society organisations, mixed-membership entities such as the World Economic Forum, and others have taken and can take the lead in creating and shaping debate. At the same time, a serious debate is needed about how to modernise the UN system and the EU that in their decision-making and internal organisation still reflect the realities of the mid-twentieth rather than the twenty-first century.
- **GR6: Active acceptance of policy interdependence.** Governments and other actors must recognise policy interdependence and pursue positive-sum solutions, where appropriate but also where such solutions might not be evident from the outset. This calls for a new multilateralism and a move away from simplistic approaches to national interest from ages past.

Responsible Sovereignty

In her chapter on 'Meeting Global Challenges: Assessing Governance Readiness', Inge Kaul concludes that while the awareness of interdependence has certainly been growing and reforms in national-level externality management appear to have advanced, most initiatives seem to stay within the existing governance moulds that begin with narrow notions of the national interest. The current resurgence of policies that favour such narrow notions as opposed to a pursuit of positive-sum strategies is clearly seen at the EU level. A major reason for much of the policy stalemate we are witnessing is that states pursue such policies even though global power constellations, including those between states and markets, have changed.

Taken together, these factors give rise to the sovereignty paradox: States, notably their governments, are losing policymaking sovereignty, because they hold on to conventional strategies of realising sovereignty, which make them shy away from international cooperation. But, in policy fields marked by interdependence, such behaviour actually undermines rather than strengthens states' policymaking capacity.

If retreat from globalisation is seen as undesirable or infeasible, then it would be, as Kaul suggests, smart for states to exercise sovereignty so that it would be fully respectful of the sovereignty of other nations in such a way that targeted positive-sum outcomes are realised—what she calls responsible sovereignty, or smart sovereignty. It is an exercise of sovereignty not out of weakness or conflict avoidance—to the contrary it is one of strength: It is a considerate, calculating approach that anticipates the limitations of 'going it alone' while foreseeing the benefits of joint action. How countries deal with environmental matters, migration or global financial markets are cases in point: No country can expect to maximise for long the national interest at the expense of others, either by seeking to dominate or free-ride.

As long as governance reforms like those that global challenges require are being viewed from the perspective of the conventional notion of sovereignty, they do not make much sense and are, therefore, being avoided, ignored, or opposed. Likewise, as long as some countries approach the EU with a veto policy to maximise what they narrowly regard as national interest, little progress will be achieved towards good governance. The notion of responsible sovereignty offers a new governance paradigm that allows policymakers to make sense of other steps that need to be taken.

Governance Challenges in Focus: Financial and Fiscal Governance

As Mark Hallerberg and colleagues explain in their chapter focusing on financial and fiscal governance, over the past several years the world has experienced a series of financial and fiscal crises. The take-over of Merrill Lynch in March 2008 and the collapse of Lehman Brothers six months later touched off a financial crisis that spread to many parts of the world. Trade dropped precipitously across virtually all countries, and many experienced recessions. Some small countries, first Iceland and Latvia and later Ireland, faced the complete collapse of their banking sectors. Beginning in 2010, the European periphery, including Greece, Portugal, and Ireland, entered a sovereign debt crisis that continues to put pressure on the governance of Europe's common currency. The sovereign debt problems in turn worsen the balance sheets of private sector participants, such as banks.

Though financial and fiscal crises have occurred throughout history, Hallerberg and colleagues argue that globalisation and higher degrees of interdependence have exacerbated them in recent times. The example of the unfolding and management of the crisis in Europe provides several important lessons in this regard. While problems extend across borders more than before, the jurisdictions for most economic policy remain national. At the same time, decisions national policymakers take create externalities for others. This suggests that coordination of policies across borders may help all countries.

The recent crises demonstrate that there are no purely technocratic approaches to resolving or even preventing them. Policymakers at the national and international levels (and, yes, also likely the general populace) 'know the math' and can identify what needs to be done in principle to prevent such crises in the first place or, when shocks or imbalances occur, to adjust accordingly. However, any solution will have winners and losers, especially in the short term, and the political and social consequences will need to be taken into account. Thus, whether any technocratic solutions—however simple or complex—can be put in practice depends upon whether the many actors involved can resolve the trade-offs such options entail. Hallerberg and colleagues identify three that arise in particular with financial and fiscal governance challenges:

- **liquidity vs. moral hazard:** In the particular case of crisis lending, a 'bailout' directly benefits a country by providing it with the financing (liquidity) needed to service its debts, while at the same time creates moral hazard, i.e. incentives for borrowers and lenders to assume additional risk in the expectation of future bailouts.
- **accountability vs. effectiveness:** While the creation of powerful new international organisations or the delegation of further authority to existing ones might strengthen the effectiveness of financial regulation and supervision, they would also present a direct challenge to national sovereignty (as conventionally understood) and democratic accountability.
- **domestic politics vs. international commitments:** The trade, monetary, and financial policies maximising a government's domestic political support are not necessarily those most conducive to international economic stability.

Furthermore, even if such solutions adequately resolved the trade-offs, not many national or local governments have the administrative capacity in place to implement and monitor the often highly technical measures needed for fiscal and monetary reform. This is a clear governance weakness requiring the urgent attention of policymakers.

Seeking Governance Innovations

Going beyond technocratic or technological solutions, the Report introduces, examines, and, in future editions, will track governance innovations. These are novel rules, regulations, and approaches that, compared to the current state of affairs, address a public problem in more efficacious and effective ways, lead to better policy outcomes, and enhance legitimacy. Helmut Anheier and Sabrina Korreck's review of governance innovations in this edition reveals that, despite the emerging global challenges and pressing local

ones, no larger ideologies or visions of and for governance are being developed—let alone debated—that in scale and ambition rival the organising and mobilising power of neo-liberalism or social democracy. The innovations are about making systems more efficacious and effective, like the low-profit, limited liability company (L3C) form that brings legal legitimacy and stability to social enterprises, the Open Government Partnership in helping governments enhance transparency, or the German/Swiss ‘debt brake’ that institutes a new rule to reign in or avoid fiscal imbalances. However, they are not generally about some new overall attack on root causes of some systemic ill or another, nor about the pursuit of more fundamental reforms, especially at the global level.

The cases highlighted underscore the importance of understanding governance as a multi-level and multi-actor process. For example:

- **Chiang Mai Initiative Multilateralisation:** In the wake of the 1997 Asian financial crisis, the South-east Asia region’s countries sought a mechanism to provide sufficient foreign currency reserves to stave off speculative attacks and prevent financial contagion. By pooling foreign currency, the CMIM shows how global challenges can be addressed at the regional level. Recognising their interdependence, countries engaged in a smart exercise of responsible sovereignty.
- **Ushahidi:** Effective crisis response is often hampered by the unavailability or inaccuracy of information. Stemming from an effort to track riots following Kenyan elections in 2008, Ushahidi’s civil society network of technically savvy volunteers and citizen journalists have developed mechanisms to use crowdsourcing to facilitate the collection, visualisation, and exchange of information needed to enable quick and appropriate disaster and crisis responses by government, citizens and other actors.
- **Social impact bonds:** Lack of adequate outcome monitoring and insufficient resources for scaling up proven ideas, among other problems, frequently lead to low performance in social service provision. Social impact bonds, now being piloted in the UK, the US, and Germany, re-allocate the risks of initiating or scaling-up social service programmes among government agencies, service providers and social investors by realigning, enforcing, and adding new incentives demanding outcome performance.

As these examples show, it would be misleading to assume that one particular actor is responsible for solving a certain challenge, or that a challenge has to be tackled on a specific level. Indeed, many innovations reviewed in the Report build on cooperation from public and private actors as well as civil society, often linking the global to the regional, even local levels.

Introducing a New Generation of Governance Indicators

Attempts to quantify governance have grown in scale and scope in recent years. By and large they rarely measure outcomes, generally fail to capture the multi-level, multi-actor nature of governance, and remain silent on the overall fit between today’s governance requirements and the arrangements in place. In their chapter, Helmut Anheier, Piero Stanig, and Mark Kayser outline a proposal for a new, conceptually grounded system of governance indicators that can be developed over time. 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.

The measures are presented in three ‘dashboards’ covering different levels of governance activities, i.e. transnational, national and city, and assembling data from a variety of official and other sources, including citizen and business surveys. An initial analysis of some of the data collected for the Transnational

Governance Dashboard, reflecting actors' behaviour in international cooperation arenas, reveals that, among countries, governance readiness is clearly lacking in many respects. Voting at the UN General Assembly was a clear case of how countries exercising 'old style' sovereignty are caught in a self-inflicted stalemate that built up over decades and now may well threaten the long-term viability of the institution. At the same time, there are also positive signs, and indications that responsible sovereignty at the international level is not only possible and feasible, but that it ultimately pays off as the examples of the World Trade Organization and UN peacekeeping contributions showed.

Turning the focus to public sector administrative capacity, available expertise, and civil society strength, the measures comprising the National Governance Dashboard allow us to examine, among others, the link between civil society and transparency, a set of practices generally agreed to be an element of good governance. Anheier, Stanig, and Kayser found that where civil society is stronger, i.e. exhibiting high levels of civic engagement, a strong organisational infrastructure, and egalitarian recruitment, governments are more transparent. This is so in cases ranging from Germany, Sweden, the UK, and the US to Spain, Brazil, South Africa, and India. Conversely, where civil society is weaker, as in Vietnam, Rwanda and China, transparency is also at the low end of the scale. One might plausibly infer that a vibrant civil society contributes to good governance.

These and other findings, as well as their implications, are examined in greater detail in the Report.

Conclusion

The Report does not lament the many changes taking place in the world today, nor does it bemoan the often-lacklustre performance of many actors charged with the governance of public problems. The Report's concern is with innovation and improvement toward a system of good governance based on a broader notion of the responsible sovereignty of actors—be they governments, corporations, or civil society institutions. In this respect, Helmut Anheier concludes the Report by making seven recommendations to advance the notion of responsible sovereignty and change the still dominant but increasingly dysfunctional emphasis on national or corporate interests as zero-sum:

Recommendation 1

There is a great need for policy makers and analysts to identify positive-sum solutions to public good problems. The search for such solutions has languished for too long, and it is time to put it on at least equal footing with those advocating the pursuit of narrow national or corporate interests. This requires resolving possible trade-offs, as Hallerberg and colleagues stressed, and constructing mutually beneficial policy bargains, at least in policy areas of interdependence that require all to come 'on board'.

Recommendation 2

Such a shift toward positive-sum thinking could facilitate and, in turn, be itself strengthened by modernising the conventional notion of sovereignty and fostering a global common understanding of responsible sovereignty. As Kaul argues, a responsible—smart—exercise of sovereignty would take the interdependence rather than the singularity, and indeed insularity, of the nation-state as its starting point.

Recommendation 3

To initiate a global policy dialogue on this issue, as Kaul also suggests, the UN Secretary-General should consider establishing a high-level commission on responsible sovereignty, charged with developing the concept and its policy implications.

Recommendation 4

Such a task should include a systematic assessment of the potentials and weaknesses of multilateralism, and major regional organisations like the EU, Shanghai Cooperation Organization, ASEAN, Organization of American States or the African Union should be encouraged to do so.

Recommendation 5

Collaboration among actors across levels and fields is to be encouraged to bring about governance innovations; to detect where such innovations occur and where not and why; and to assess their potential for replicability and scalability. We propose a systematic search for areas where such collaboration happens—and does not happen, but could, and why.

Recommendation 6

There is a strong need to strengthen governmental and nongovernmental capacity in terms of efficacy—managing information, creating knowledge, and finding solutions to policy problems. Governance readiness requires an administrative and technical capacity that is strong; in many places, even in many OECD countries, it is currently often weak and underdeveloped. This also requires investing in a new generation of governance indicators.

Recommendation 7

Social science curricula are to be adjusted and revised to take account of the new realities and help educate a new generation of policy experts, administrators and managers who not only understand interdependence and its challenges but also embrace its opportunities. The same applies to professional schools in the field of law, accounting, and, especially, business management.

The authors of the chapters in this Report stress throughout that no quick fixes in the form of some technocratic solution or another can solve key public problems, be it in global finance, sovereign debt, or the environment. Nevertheless, at various governance levels and across many places, innovations are taking place that seek new ways to handle trade-offs and to improve existing systems and policy outcomes. A review of the many ideas, proposals and approaches that seek to improve governance, itself a core task of this Report, also revealed that there seems, at present, no overarching plan or vision guiding them. Especially given this void, advancing the notion of responsible sovereignty appears as a reasonable and achievable way forward.

Call for Action

Policy Analysts

- Modernise notion of sovereignty
- Search for positive-sum solutions

Policy Makers

- Push positive-sum outcomes
- Strengthen capacity through smart collaboration

International Community

- Establish high-level commission on responsible sovereignty
- Assess new regionalism

Academia

- Modernise social science, public policy, and legal curricula to take account of new realities

About the Hertie School of Governance

The Hertie School of Governance is an independent academic institution in Berlin, Germany, with an international, interdisciplinary faculty engaged in teaching, public debate, and policy research in fields including global governance, political economy and finance, public management, and leadership. The School was founded in 2003 as a project of the Hertie Foundation, and has a wide range of national and international supporters.

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and local bookstores.

A companion edited volume, *Governance Challenges and Innovations: Financial and Fiscal Governance*, is also available from OUP.

More information on governance, this Report, and other data and resources can be found at www.governancereport.org

