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The Great Recession, Regulatory Failure and Global Governance

Succumbing to one form of interdependence may be the price one pays for avoiding another.

(Keohane & Nye 1974, 61)

1.1 Global governance and financial crisis

Did global governance through transgovernmental networks lead to regulatory failure that caused the Great Recession? And, if yes, should we enhance global cooperation to prevent future crises or focus on the national level? In 2005, bank supervisors from industrialised nations – within the transgovernmental network of the Basel Committee on Banking Supervision – agreed to harmonise their regulatory standards with the purpose of controlling excessive risk-taking of globally active banks and pre-empting global financial turmoil. In 2009 these standards were considered a cause of the Great Recession as they had facilitated the spread of imprudent practices globally, rather than enhancing regulation. Their origin, the transgovernmental network of the Basel Committee, is frequently considered problematic with a view to regulatory failure. Nevertheless, in 2010, the BCBS presented its new framework, Basel III, as the centrepiece of global regulatory reform, which the G20 happily endorsed. Can we expect that these standards, this time, increase rather than undermine financial stability even though they originate in the same governance networks and through the same policy processes?

More generally, should we enhance the global approach to prevent future financial crises? Or should we rather focus our efforts to regulate banks on the national, or maybe the regional, level? In the
public's attempt to regain control over the financial sector without choking its growth engine, the seeking of the optimal, or at least best possible, locus for policy and regulatory action is crucial. Pundit and scholarly opinion is divided. Some tend to favour global or transnational governance approaches to the standard-setting problem (Slaughter 2004), some see the nation state as the locus of authority to be better suited to providing the necessary confluence of polity and market (Germain 2010). Probably, most authors (including those mentioned above) would argue that the spectrum of realistic options involves some mix of both national and global/transnational authoritative structures and agents. This leaves us with a complex global governance (dis)order (Cerny 2010b, Lake 2010), in which nation state bound and nation state-transcending governance layers interact in setting the rules to reduce risks of future global financial turmoil.

In this book, I argue that a persistent key problem of global financial regulation as well as other transnationally governed areas of the global political economy is that policymakers pursue both, national and transnational governance, but do not reconcile these approaches. The unchecked simultaneity of national and transnational influence in (transnational) standard-setting is a major, unresolved problem at the core of global governance, since it leads to durable disorder and, in consequence, to global policy failure. With a view to the financial governance reforms in response to the Great Recession, I argue that the unreconciled competition of national and transnational governance continues to condition global policymaking, which implies the undiminished probability of future regulatory failure and turmoil – the reforms actually foster this aspect of the pre-crisis constellation.

1.2 Transgovernmental governance and regulatory failure

This book is about the transgovernmental harmonisation of standards to regulate globally active banks – in short global banking regulation – and in particular about the structures and dynamics of its global political economy. More specifically, the study is about the effects that the Basel Committee on Banking Supervision (BCBS, Basel Committee) and its most recent agreements, the Basel II and III frameworks, have on the stability of the global financial system. Thus, my aim is to explain the role that global governance plays in regulatory failure, a main cause of the Great Recession.