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Thinking rationally about hierarchy and global governance

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ABSTRACT

Recent scholarship on globalization has conflated methodological critiques of rationalism with ontological arguments. American rationalist paradigms of IPE, it is argued, are too state-centred and utilitarian to offer convincing explanations for emerging non-state forms of global governance. In response, this essay argues that rationalist theories do provide important theoretical tools to understand the political economy of globalization, even in its hierarchical forms. An examination of the changing forms of contractual relations between international organizations and non-governmental organizations, the functions of international credit rating agencies, and the growth of offshore tax havens, shows that underlying utilitarian incentives for political behaviour can be uncovered and explicated, even within these non-state forms of contemporary global governance. Consequently, the appropriateness of any given IPE method should depend upon the research question asked, not pre-existing assumptions about the inherent advantages of either rationalist or non-rationalist approaches.

KEYWORDS

Hierarchy; global governance; rationalism; NGOs; credit rating agencies; tax havens.

INTRODUCTION

The first ten years of RIPE have coincided with the spawning of a gigantic literature on the origins, governance and implications of globalization. While approaches to the subject are diverse, a growing consensus has emerged among many IPE theorists – historical institutionalists, Marxists, economic geographers, post-colonial theorists, Gramscians, and critical theorists – that globalization should be viewed as a hierarchical set of structures, institutions, and processes. Of course, there are various strands to the 'globalization as hierarchy' approach. Some scholars have revived

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the concept of hegemony, particularly American hegemony, to explore how the US and its ideological allies dominate the institutions of the global economy such as the IMF (Stiglitz, 2002) and the World Bank (Wade, 2002). Other theorists have focused on the hierarchical nature of the global economy itself, pointing to its uneven distribution of power and extraordinary reproductive capacities (Mittelman, 2000). Still others have argued that globalization as a political and economic process is an unbridled form of new imperialism, no different from imperial orders of the past (Barkawi and Laffey, 1999; Petras and Veltmeyer, 2002).

Even those who make the case that this new global system is not comparable to previous politico-economic orders find it difficult to discard altogether the hierarchy and imperialism analogies. For instance, Michael Hardt's and Antonio Negri's much-acclaimed neo-Marxist opus proclaims that we are living in a post-imperial world, but still chooses the label 'Empire' to denote the 'single logic of rule' that supposedly characterizes the contemporary, deterritorialized global system (Hardt and Negri, 2001). The language of hierarchy, hegemony, and empire has become the analytical prism through which scholars explain the emerging politics of globalization.

In part, the theoretical turn to hierarchy represents a backlash against traditional IPE theories and methodologies, usually understood as American in origin. Two critiques – one ontological and one methodological – are usually levelled by the new globalization theorists. First, prevailing IPE approaches such as neo-liberalism or neo-realism are too state-centred in their assumptions to fully appreciate the growing importance of non-state actors and various transnational networks (Strange, 1994). Second, American IPE's privileging of rationalist approaches is overly fixated, micro-analytically, on actors pursuing their set preferences in an instrumental manner, thereby rendering rationalism incapable of grasping the generative origins, institutional architecture, and ideational components of this multifarious global economic order. Consequently, many argue, rationalist theories of IPE tell us little about important global issues such as the dynamics and volatility of the international financial system (Wade, 1998), the evolution of state relations with transnational corporations (Strange, 1996; Amin and Palan, 2001), or the changing nature of economic institutions in relation to prevailing hegemonic economic ideas (Blyth, 2002). All too often, however, these two different critiques are conflated into the proposition that rationalism, as a theoretical approach, is inherently incapable of explaining the new features of the global economy.

This paper questions the theoretical utility of abandoning rationalist approaches to the study of globalization and argues that the literature on the political economy of organization, hierarchy and contracting has much to contribute to our understanding of the emerging dynamics of global governance. I draw attention to three such globalization-related issues – transnational NGOs, international credit rating agencies and microstates – and explore how new hierarchical processes and incentive structures are restructuring interactions among international actors. Across all of these issue areas, we are witnessing a reconfiguration of political authority that is pushing both state and non-state actors to behave in ways that are strategic, utility-maximizing and relatively predictable. My point is not to rehash the tired theoretical position that material factors matter more than ideational ones. Rather, I hope to show that even if we reject state-centred accounts of IPE in favour of more globalist or hierarchical understandings of economic governance, rationalist formulations still offer invaluable insights into the political dynamics of the contemporary international system.

NEW GLOBAL FORMS: CONTRACTUAL RELATIONSHIPS AND TRANSNATIONAL GOVERNANCE

One of the hallmarks of the present international economic system is the global outsourcing of production by firms along with a widespread belief that such flexible sub-contracting promotes efficiency (Reich, 1991; Rodrik, 1997). In the political sphere, too, a wave of privatization and outsource contracting has swept across advanced industrialized and developing countries, encouraging states to retrench from their traditional roles as exclusive providers of public goods and services. As a result, we are witnessing an explosion of public–private partnerships and a striking rise in the use of private contractors by the state in almost all areas of traditional state governance including transport, utilities, urban planning, health care and even education.

While these domestic trends are well documented, the last decade also has seen a parallel set of developments in international and transnational governance. Driven by seething critiques of alleged project inefficiencies, waste and mismanagement, international organizations – like their state government counterparts – are increasingly delegating their activities by subcontracting their projects to both for- and non-for profit international non-governmental organizations (NGOs) (Smillie, 1995; Berrios, 2000).

This 'outsourcing' trend is rarely highlighted in the theoretical literature dealing with the role of NGOs in international politics. Instead, most IR scholars have celebrated the spectacular growth of the NGO sector over the last decade as the harbinger of a global civil society and a new benign form of transnational governance (Mathews, 1997). Theoretically, scholars have treated the NGO sector as the antithesis of the proliferation of transnational corporations and economic globalization, arguing that they are motivated primarily by liberal norms and universal values, while bringing together like-minded local, state and international actors in new networks of 'principled' transnational governance (Keck and Sikkink, 1998).

Such optimistic views of the transnational sector do not account for the causal effects of this emergent subcontracting process on the very activities and behaviour of NGOs. Even the most normatively driven NGOs are entering an increasingly competitive market in which they must outbid and undercut competitors in order to procure project contracts, much like MNCs do over international tenders. Moreover, the majority of these contracts, once secured, are short term and renewable, adding to NGOs' fiscal insecurity and driving them to do everything possible to secure contract renewal. As I have argued elsewhere, this system of competitive sub-contracting is creating a perpetual 'scramble' among NGOs, driving them to doggedly compete against each other in order to secure their fiscal survival (Cooley and Ron, 2002).

Far from being just a 'technical' issue, this system of procurement and marketized competition is rapidly transforming the character and functions of large parts of the transnational world. From providing humanitarian relief in areas ravaged by war or natural catastrophe, to constructing the institutions of a market economy in post-Communist countries, to promoting democratization and human rights, NGOs are increasingly subjected to the discipline of market environments. For their part, international organizations and country donors are steadily withdrawing from their traditional roles of offering expertise, material resources, and active involvement in field operations and, instead, are becoming the figureheads, conduits and lobbyists for the dispersal of funds to NGO contractors. The majority of UNHCR's 2000 $1 billion budget was spent on hiring contractors for its various projects.[1] In 2002, the EU dispersed more than 640 million euro to 200 contractors for its humanitarian aid initiatives while during the same year it dispersed 645 million euro and 430 million euro for various contracted projects in the Balkans and Eastern Europe/Former Soviet Union, respectively.[2] Similarly, the World Bank's recent civil society agenda is being pushed by powerful Western NGOs that rely on the international body and its initiatives as a source of contract procurement. It would appear that 'contract fever' is taking over most international organizations and their outreach programmes.

Behaviourally, it would seem appropriate that we study these new relational forms with theoretical tools designed to reveal the incentives and explain the actions of rational contracting parties. Specifically, relations between IO donors and NGO contractors can be viewed as a principal–agent relationship in which the IO is the principal and the NGO is the agent (Pratt and Zeckhauser, 1985). As in any relationship of contractual authority, contractor-agents are meant to pursue the donor's objectives, but will also use the resources of the donor to pursue their more narrow organizational interests, in this case procuring and renewing their contracts. As a result, contractors have incentives to strategically manipulate informational asymmetries, monitoring mechanisms, uncertainty, and renegotiation procedures, and ignore procedures designed to align their incentives with those of the principal donor (Miller, 1992). The literature on hierarchical organization has much to tell us about under what conditions contracting NGOs take shortcuts, obscure problematic projects, and inhibit broad-based collective action with other NGOs that might be competing for the same funding sources in the same sector (Cooley and Ron, 2002).

In turn, such organizational environments prompt NGOs to behave in strategic and utility-maximizing ways that have important effects on the reconfiguration of international power and authority within the broader international system. Of vital concern here is the issue of accountability. International organizations that delegate their functions to contractors can accept credit or defer responsibility for a project once it has been contracted out. For instance, an IO or state that delegated an unsuccessful project to an NGO has few incentives to examine the original assumptions about the project's design or utility and, instead, can absolve itself of direct knowledge or responsibility (Smillie, 2001). In fact, once a donor or IO contracts the project out, it is not clear why it really should involve itself in the close monitoring or supervision of the contractor at all. Likewise, a project contractor that runs into difficulties has absolutely no incentives to report or acknowledge these problems to its donor, especially if such information is likely to jeopardize future contract renewals. Accordingly, the lines of accountability in the transnational sector are much blurrier under the contracting system than when IOs exclusively planned, administered and implemented their own projects.

The adoption of the sub-contracting model is rapidly diffusing into other areas of international governance, including areas traditionally associated with state security. Reconstructing war-torn countries is increasingly becoming the hunting ground of semi-experienced transnational contractors, as is providing peacekeeping operations and security services in troubled regions. Over the last decade, state governments, MNCs, and international organizations have increasingly turned to private security corporations (PSCs) to provide a number of security services, from logistics and military training to guarding valuable assets such as mineral reserves (Singer, 2001). This trend is not just confined to developing states; the US government has steadily increased the number of security services it is outsourcing and PSCs have played large roles in recent US military operations in Kosovo, Afghanistan and Iraq. As with IO sub-contracting, states that rely on contractors for traditional international security operations risk bypassing or even subverting institutions of routine oversight and legislative accountability (Avant, 2003).

Governments can also use PSCs as policy-implementing proxies and at the same time deny any formal involvement or positions in those conflicts. Such was arguably the case in 1995 when the Croatian army used NATO-style tactics to blitz the Serbian army and recapture Krajina, just months after they had been advised on military training and tactics by the American PSC Military Professional Resources Incorporated MPRI (Avant, 2003; Brayton, 2002). For its part, the US Department of State was able to maintain its official stance of neutrality and deny any direct involvement in the operation. Similarly, the US decision by the Bush administration to replace the US Special Forces entrusted with providing personal security for Afghanistan president Hamid Karzai with a contract given to the Virginia-based PSC Dyncorp was interpreted by some commentators as an attempt to absolve itself of future accountability in the matter.[3] In the same vein, given USAID's heavy reliance on corporate contractors such as Bechtel in the current reconstruction of Iraq, it is not exactly clear which party bears the political responsibility for these efforts.

To sum up, the contracting process is rapidly becoming the normal form governing relations among IOs, state donors and NGOs. But while contracting may solve certain problems, these new relational forms raise both philosophical and behavioural questions for IR and IPE theorists. Ontologically, using positive theories of contracting and organization to explain the political economy of these transnational relations makes much sense, precisely because the contractual process creates readily identifiable and predictable incentives. As the trend in favour of delegation through contracting continues, for both international organizations and states, we should be able to observe behaviour consistent with the predictions of agency theory, albeit in previously unexplored transnational settings.

NEW GLOBAL FUNCTIONS: CREDIT-RATING AGENCIES AS GLOBAL REGULATORY BODIES

While the marketization of traditional forms of governance is creating new hierarchical forms, we also see evidence of increasing functional differentiation in contemporary global governance. An often-cited example is the changing global division of labour and accompanying 'race to the bottom' that is being created by states bargaining with globally mobile transnational corporations. But there are also other areas of functional specialization within the overall global economy that remain relatively undertheorized. Perhaps the most overlooked of these are the private credit rating agencies of international financial markets.

In a recent bestselling book on globalization, Thomas Friedman of the *New York Times* likened Moody's credit rating agency to a new global superpower, reserving the ability to bestow substantial rewards and wreak devastating havoc on a country merely through adjusting its bond rating (Friedman, 1999). Together with Standard and Poor's and Fitch, the 'big three' credit rating agencies have emerged as perhaps the most significant brokers of information and capital access in the global financial system. Although they were established during the interwar years as providers of information to investors, their role has significantly expanded in the post-Bretton Woods era as both sovereign countries and private companies have increasingly turned to private capital markets for their borrowing needs. No longer just in the business of evaluating the risk on corporate debt, credit rating agencies are responsible for rating the debt of sovereign countries and multinational corporations.

In both cases, a borrower's ability to raise capital on the private markets is conditional on obtaining an investment grade rating from the 'big three'. Conversely, a downgrade to 'junk bond' status inhibits access to capital or raises the interest rates that borrowers must offer to prohibitively high levels. In addition, a state with a poor rating or no rating at all will find it difficult to attract direct investment and offer a credible guarantee to potential investors that it will not renege on future deals. Moreover, because only the big three have the status of 'nationally recognized statistical rating organization' (NRSRO), they are effectively protected from potential competitors by the SEC and maintain exclusive authority over the issue area.[4] Although the credit rating agencies themselves often argue that they are merely in the business of information provision, in practice these informational ratings function as exclusive providers of global regulatory licenses (Sinclair, 1994). In fact, the Basel 2 international agreement on bank-capital rules requires that, by January 2007, national bank regulators use these agencies' ratings as a standard measure of a bank portfolio's risk.

As a result, credit rating agencies not only impact access to debt markets or actual interest rates, but they affect the actual behaviour of states and domestic economic policy-makers. As states are increasingly compared to and judged by the same criteria that are used to evaluate corporate actors, states themselves are likely, in a process of institutional isomorphism, to adopt the effective organizational traits and characteristics that will guarantee them favourable future ratings (Spruyt, 1994). Credit rating agencies and the de facto regulatory power they exercise now forces sovereign states to strategize and justify political-economic decisions with reference to ratings criteria. Furthermore, states must now conduct credit-rating diplomacy, where they lobby agencies to improve their rating, and attempt to show that future governmental policy on economic matters is in line with the expectations of the industry. This very process is non-transparent and can potentially create a conflict of interest for agencies, given that they are paid by states to issue a rating. Thus, just as the sub-contracting is leading to the marketization of NGO behaviour, the growing importance of credit raters is corporatizing the behaviour of states.[5]

When compared to the amount of research generated on issues such as international trade or international institutions such as the IMF, World Bank or the WTO, our knowledge of the workings and influence of credit rating agencies is remarkably thin. Obviously, much of this gap stems from the inherent difficulties involved in gaining access to the decision-making procedures and internal workings of these private sector actors. But it is also true that many macro or historically oriented critiques of the international financial system and monetary order miss the subtle manner in which the credit rating regime has evolved over the last 20 years.

NEW GLOBAL ROLES: MICROSTATES AS PARTIALLY-SOVEREIGN PREDATORY ACTORS

Concurrent with the rise of private regulatory capacities has been the rise of microstates in the global economy. As Ronen Palan points out, the main commodity that these microstates deal in is the commercial selling of their sovereignty (Palan, 2002). Microstates offer sites – usually virtual – from which global economic actors (firms, organizations and individuals) can bypass traditional sovereign demands for disclosure, regulation and taxation. By offering services such as incorporation, banking, brokerage accounts and internet hosting, microstates effectively undercut the traditional sovereign state's ability to exercise its regulatory tasks and capture rents, in the form of a another country's tax base or regulatory fees, in these functional areas.

While the legal designation of offshore can be traced back several centuries, the proliferation of information technologies in the 1980s and 1990s both accelerated the offshore rush and broadened the roles and functions of microstates (Palan, 2002; Hudson, 1998). The ability to transmit money and information digitally has made it possible for these jurisdictions to enter the financial services market relatively cheaply. In addition, the rise of the internet has also brought new opportunities to microstates, both as a technology to facilitate instantaneous, unregulated transactions and as a source of cash-flow from site hosting, especially gambling-related sites.[6] Other types of on-line services, such as portals for file-sharing and digital downloads, seem set to proliferate from offshore sites as they are banned from OECD countries for facilitating copyright infringement.

The overall impact of offshore tax havens is now starting to attract more public attention, in part because of their dramatic impact on state revenues. As a result of offshore incorporation, US corporate tax receipts have actually fallen from about 25 percent of total tax revenues in the 1960s, to less than 9 percent now.[7] As more and more companies choose to incorporate in microstates, states have few options available to curtail the exodus. Even after a contentious and widely publicized debate, the US Senate still narrowly defeated a bill that would have prohibited the new

Department of Homeland Security from procuring military hardware and services from US companies registered offshore. For its part, the Internal Revenue Service is trying to make some piecemeal inroads into eroding tax haven secrecy by summoning the transaction information for credit cards issued to American individuals from tax haven banks.[8]

OECD states have also undertaken a number of recent concerted initiatives to combat illicit activities. One of the more intriguing conflicts in the contemporary international economy is between offshore tax havens that profit from providing this array of functions, and the international regulatory regimes that are being constructed to monitor these activities. Estimates of the exact value of offshore holdings vary dramatically, but the IMF estimates that over $5 trillion worth of assets are held offshore and that between $800 billion and $2 trillion is laundered annually through various global tax havens (Wechsler, 2001). The OECD's collective effort to pull into line rogue tax havens with the threat of economic sanctions has forced some minor behaviour adjustments, but the collective action problem has impeded the strengthening of the regime. As of 18 April, 2002, seven tax haven jurisdictions declared that they had no interest whatsoever in cooperating with the OECD global tax cheating initiative and many others have been accused of foot-dragging by the OECD commission.

Ironically, the theoretical link between globalization and 'empire' might be quite strong in microstates, although not in the way usually thought of by IPE theorists. While not all tax havens are contemporary colonies or dependencies, the legal advantages of non-sovereignty are significant (Naylor, 2002). British colonies and dependencies such as the Cayman Islands, Bermuda, Gibraltar, Montserrat, and the Channel Islands offer the advantages of Britain's well-established legal system and financial stewardship, without the complicating regulatory institutions that characterize a nation-state. Similarly, jurisdictions such as Andorra, Liechtenstein and Monaco, in Europe, and Norfolk island, the Cook Islands and the Marshall Islands, in the Pacific, retain an ambiguous sovereign status that enables them to circumvent international regimes and collaborative regulatory efforts by nation-states.

The rise of credit rating agencies and microstates is a noteworthy, but also a relatively undertheorized part of the emerging global political economy. In both instances, an emerging functional division in the global economy is driving political actors to behave in rational and even rent-seeking manners. True, as Palan and Amin argue, rationalist approaches cannot tell us how 'on-shore' and 'offshore' as categories came to be legally constructed and accepted (Amin and Palan, 2001), nor can they tell us why credit rating agencies adopt the specific criteria they do to judge a state's financial health. Then again, it is unclear why such generative questions should be the exclusive focus of our research. These categories might, indeed, be social constructs or legal fictions, but the increasing appropriation of state functions by microstates remains a competitive and lucrative business. Acknowledging the historical and legal origins of the offshore status does not alter the material incentives of tax havens to act in a predatory fashion and seize rents in the form of another country's tax revenues.

CONCLUSIONS: RATIONALIST AND NON-RATIONALIST APPROACHES TO HIERARCHY

I have briefly pointed to three areas over the last decade where emerging governance forms have changed or redefined relations among global economic actors. From the effect of the sub-contracting system on the behaviour of NGOs, to the corporatization of state behaviour by credit-rating agencies, to the predatory incentives created for tax havens and microstates, global political actors are rapidly becoming rationalized by the organizational fields and contractual hierarchies in which they find themselves enmeshed. At the same time, the preferences of these global actors are becoming relatively easy to identify: NGOs concerned with their fiscal survival prefer to renew existing contracts and to secure new projects; states prefer to raise their credit rating and will lobby agencies in this effort; and tax havens prefer to capture as much of the global tax base as possible. In both form and function, the global economy is generating new types of hierarchical institutional arrangements whose dynamics seem to have relatively straightforward, material explanations. I have argued that positive theories of political economy have much to contribute to our understandings of these processes, in part because – unlike many prevailing accounts of the hegemony of globalization – they problematize the actions of actors engaged in hierarchical relations of contractual authority.

One of the central concerns of the RIPE readership remains the broader debate on the strengths and weaknesses of various theoretical and methodological approaches to the study of the global political economy. Neither positive nor critical theories should have exclusive rights to analysing hierarchy in the international economy, but they each have their distinct strengths. Critical and more historical approaches might go a long way in explaining the generation of a number of transnational governance mechanisms. These approaches are also useful for reflecting the underlying assumptions underpinning rationalist analyses. However, rationalist theories are more effective at identifying and specifying the incentive structures and their behavioural consequences once these governance mechanisms have become institutionalized. Admittedly, this sequential approach to IPE methodology is crude and does paper over important areas of difference, but I believe that it also draws attention to fundamental distinctions in the research agendas of rationalist and non-rationalist IPE theories.

There is an irony here. As many scholars of IPE – including many contributors to RIPE – are increasingly voicing their discontent at the perceived hegemony of American rationalist paradigms, relations among important actors in the global economy are becoming increasingly functionally differentiated, corporatized and, yes, rationalized. Thus, abandoning all rationalist IPE theories and methods in favour of historical, critical or constructivist approaches carries with it the danger of discarding a set of theoretical approaches whose analytical assumptions increasingly reflect the world that they purport to explain.

One need not be a critical theorist to share concerns about growing global inequality, socioeconomic deprivation and the destructive power of unchecked global capital mobility. Nor does one need to view economic globalization as imperialism to identify current examples of actual imperialist behaviour in the international system. However, as social theorists and social scientists, part of our theoretical task must remain to offer explanations of how these new globalizing processes work, what incentives they create for involved actors, and, as a result of these shifts in form and function, how international power relations are being transformed, reinscribed and subverted. In sum, I hope that scholars from both sides of the Atlantic interested in the role of hierarchy in contemporary IPE will consider the explanatory concepts offered by rationalist theories, even as they critically reflect upon their underlying assumptions.

NOTES

1 Philippe Rekacewicz, 'How the Burden of the World's Refugees Fall on the South', *Le Monde Diplomatique* [English version], (April 2001), p. 19.
2 Data from the European Union budget website, as of Feb. 6, 2003. http://europa.eu.int/comm/budget/abb/abb_2002/apb/relex_en.htm
3 Jonathan D. Tepperman, 'This is Not the Job of Soldiers for Hire; The US Military, Not Mercenaries Should Guard the Afghan President', *Los Angeles Times* (Nov. 26, 2002), p. B 13.
4 *The Economist*, 'Rating Agencies; Exclusion Zone', (8 February, 2003: 65).
5 Of course, the global economy's devolution of information provision and rating services to a few private actors guarantees neither efficiency nor accuracy in these functions, as the East Asian financial crisis made clear.
6 For instance, the domestic US book-making industry has been decimated by the proliferation of on-line casinos and book-makers, accessible from private homes, but subject to none of the domestic or state regulations because of their formal registration in locales like the Cayman Islands and Bermuda.
7 Reuven S. Avi-Yonah, 'World Tax Evasion', *The American Prospect* (May 22, 2000: 29).
8 William Garafolo *et al.* 'IRS Issues More Summonses for Offshore Credit Card Data', *Journal of International Taxation* (November 2002: 44–45).

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