ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS
FELLOWS' DISCUSSION PAPER SERIES

REGULATORY NETWORKS AND THEIR LIMITS

Pierre-Hugues Verdier

Discussion Paper No. 22

9/2008

Harvard Law School
Cambridge, MA 02138

Contributors to this series are John M. Olin Fellows or Terence M. Considine Fellows in Law and Economics at Harvard University.

F02, F53, F55, K33

REGULATORY NETWORKS AND THEIR LIMITS

Pierre-Hugues Verdier[*]

(Forthcoming, *Yale Journal of International Law*, Vol. 34, No. 2, Spring 2009)

Abstract

In recent years, the rise of transgovernmental regulatory networks (TRNs) has attracted the attention of international law scholars. Advocates of TRNs contend that, by cooperating directly with their counterparts abroad to address common regulatory issues, national regulators are creating a revolutionary system of effective global governance without centralized world government. This article advocates a more cautious approach to this phenomenon. Based on a theoretical analysis of TRNs, it argues that they may be successful in overcoming relatively simple problems of international regulatory coordination in cases where state interests converge. However, when faced with more difficult regulatory issues where the choice of a specific policy has distributive implications, or where participating states have incentives to defect from common standards, TRNs are unlikely to succeed. In such cases, their effectiveness is undermined by the numerous domestic legal and political constraints faced by national regulators and by the institutional incapacity of TRNs to monitor or enforce the rules they adopt. The article then analyzes three of the most salient examples of TRNs—in international securities regulation, banking and antitrust—and shows that the institutional weaknesses inherent in TRNs have limited the effectiveness of regulatory cooperation in these areas. It concludes that the more ambitious claims of TRN advocates are exaggerated, and that TRNs may exhaust their potential as they successfully address less contentious issues and increasingly face distributive and enforcement problems they are ill-equipped to resolve.

[*] S.J.D. Candidate and John M. Olin Fellow in Law and Economics, Harvard Law School; Visiting Assistant Professor, Boston University School of Law. The author would like to thank Anu Bradford, Antonia Chayes, Asif Efrat, Stavros Gadinis, Jack Goldsmith, Larry Helfer, Howell Jackson, Beth Simmons, David Singer, Michael Waibel and participants in workshops at Harvard Law School and the Weatherhead Center for International Affairs for their comments on prior drafts. The author gratefully acknowledges the support of the Trudeau Foundation, the Social Sciences and Humanities Research Council of Canada and the John M. Olin Center for Law, Economics, and Business at Harvard Law School.

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INTRODUCTION

Since the end of World War II, ambitious institutions and regimes have emerged to regulate international economic life. The GATT institutes detailed legal disciplines on trade restraints, and in its new incarnation as the WTO, its jurisdiction has been extended to encompass intellectual property and services.[1] The IMF initially wielded extensive authority over the international monetary system and, though its mission has been in flux since the 1970s, it retains a leading role in the international financial architecture.[2] Numerous other regimes control trade in specific goods such as nuclear materials, weapons and cultural property. Likewise, the expanding corpus of international environmental law increasingly affects transnational business.

Despite these developments, economic regulation in crucial areas such as competition, securities and banking remains first and foremost a domestic phenomenon. The attempt to set up a global competition regime foundered in 1947 with the Havana Charter, as did periodic attempts to resuscitate the idea.[3] Transnational securities transactions are subject to overlapping and sometime contradictory national laws. Likewise, national regulators, not global authorities, supervise internationally active banks.[4] In the absence of international treaties and institutions, national regulators have created informal networks to exchange ideas, coordinate their enforcement efforts, and negotiate common standards.

In recent years, scholars interested in global governance have devoted substantial attention to the promise and perils of these transgovernmental regulatory networks (TRNs).[5] In its most ambitious form, the theory of regulatory networks claims that TRNs

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[1] *See* Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994); General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994); on intellectual property, *see* Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 320 (1999), 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994); on services, *see* General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994).

[2] *See generally* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW ch. 19 (2002).

[3] *See* MICHAEL J. TREBILCOCK & ROBERT HOWSE, THE REGULATION OF INTERNATIONAL TRADE 593 (3d ed. 2005).

[4] Because this Article is concerned with regulatory cooperation in the international context, I leave aside the remarkable level of regional integration achieved by the European Union. For my purposes, the European institutions may be seen as a single national regulator.

[5] *See* ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER (2004). Slaughter defines a network as “a pattern of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the ‘domestic’ from the ‘international’ sphere.” *Id.* at 14. Other influential contributions to the regulatory networks literature include Kal Raustiala, *The Architecture of International Cooperation: Trangovernmental Networks and the Future of International Law*, 43 VA. J. INT’L L. 1 (2002-03); David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT’L L.J. 281 (1998).

illustrate a pivotal contemporary phenomenon: the disaggregation of the state in the conduct of its international relations. In this view, individual government agencies and actors negotiate directly with their foreign counterparts and reach informal understandings relating to their areas of responsibility. Their expertise and insulation from domestic political pressures allows them to solve problems that traditional international organizations cannot adequately address and, ultimately, to solve the "globalization paradox" by providing effective global governance without forming a potentially oppressive global government.[6] The main potential difficulties these theorists associate with TRNs are their lack of democratic accountability and representativeness, but they claim that these problems can be addressed by promoting adequate access and influence for domestic constituencies and developing states.

This emphasis on normative considerations presupposes that TRNs are an effective means of resolving international regulatory problems. Indeed, much of the existing literature describes in detail the origins, institutional arrangements and activities of notable TRNs, implicitly assuming that these developments demonstrate their importance in achieving international regulatory cooperation. This article advocates a more cautious approach to the TRN phenomenon. Based on a theoretical analysis of TRNs and on an examination of three networks that are widely cited as instances of successful network cooperation,[7] it argues that several fundamental constraints limit the effectiveness of TRNs and their potential to transform global governance. First, domestic constraints on the autonomy of regulators—ranging from political oversight to administrative law constraints and media scrutiny—cast doubt on their purported insulation from the kinds of domestic political pressures that make international agreements difficult to reach. Instead, this article argues, national regulators are tied to domestic constituencies by incentives and accountability structures that are much stronger than their links to a "hypothetical global polity."[8] As a result, the conflicts of state interests that often hinder formal international cooperation are likely to recur in the context of TRNs.

Second, TRNs are institutionally ill-equipped to address these conflicts. Negotiations within TRNs often involve distributive problems because they must choose between alternative rules and policies, each of which favors some states over others. Reaching a mutually acceptable outcome requires making concessions and tradeoffs across issue-areas, a political task that is not easily entrusted to regulatory agencies. It may also involve threats and other manifestations of relative power, a reality at odds with the alleged apolitical nature of the TRN process. The informal and nonbinding nature of the rules adopted by TRNs, and their incapacity to monitor or enforce them, limit their effectiveness in circumstances where states have incentives to take advantage of other participants by defecting from the cooperative solution. While these intrinsic limitations do not mean that TRNs are wholly ineffective, they point to the need for a more descriptively thorough—and normatively modest—evaluation of their strengths and

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[6] *See* SLAUGHTER, *supra* note 5 at 8-10.
[7] Those three networks are the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Competition Network (ICN). On the choice of these case studies, *see* Part II.C, *infra*.
[8] *Id.* at 29.

weaknesses. They also suggest that TRNs may gradually exhaust their potential as they successfully address coordination problems and increasingly face distributive and enforcement problems they are ill-equipped to resolve.

Importantly, however, this article does not argue that these limitations are unique to TRNs, or that specific alternatives such as formal international institutions, regional or bilateral arrangements, or unilateral regulatory action by powerful states are always preferable to networking. The limitations of these other mechanisms have been extensively studied and, in some cases, they parallel those of TRNs. What this article does argue, however, is that current evidence regarding the effectiveness of TRNs is insufficient to support the most optimistic and expansive claims regarding their transformational impact on global governance. In particular, it questions the idea that TRNs represent a "third way" through which effective global regulation can emerge without the drawbacks of formal institutions or government procedures. It shows that a close examination of three of the most salient TRNs—the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the International Competition Network (ICN)—reveals important limits of their effectiveness in addressing global regulatory problems. The intent is not to argue against networks *per se*, but to pave the way for a more realistic assessment of their strengths and weaknesses and their legitimate, but intrinsically limited, role in the largely *ad hoc* constellation of mechanisms that make up the emerging global governance system.

Part I of this article reviews the main characteristics of TRNs and the normative claims made by their advocates. Part II describes the multiple domestic legal and political constraints faced by national regulators when participating in TRNs. It then draws on international relations theory to characterize the international regulatory problems faced by TRNs and identify potential limitations to their effectiveness. In particular, it argues that TRNs are ill-equipped to address distributive problems—where states share common objectives but would prefer different solutions—and enforcement problems—where individual states can gain by defecting from the cooperative solution after it is adopted.

In Parts III to V, the limitations of TRNs are illustrated by three case studies of major network initiatives. First, an analysis of the global capital standards adopted by the Basel Committee reveals the substantial role of domestic pressures and relative power in the initial negotiations, and the failure of the network to prevent substantial inconsistencies in national implementation. The objective of creating a level playing field in international banking has not been achieved, a situation unlikely to be improved by the recent Basel II standards. Second, while developed country regulators have successfully coordinated securities law enforcement under the auspices of the IOSCO, this coordination was made possible by the prevalence of shared interests between them and is limited to procedural rules. In contrast, developed states resorted to coercive tactics to secure cooperation against fraud by offshore financial centers, whose interests favored laxer laws and less transparency. Other initiatives by IOSCO, such as its failed effort to establish global capital standards for securities firms, point to the limits of informal cooperation when domestic interests clash. Finally, while it is too early to assess the success of the ICN's initiatives to promote substantive convergence in antitrust, this new initiative takes place in an international regulatory environment still deeply shaped by unilateral policymaking and enforcement by the United States and the European Union.

Part VI finds that the case studies are consistent with the theoretical framework elaborated in Part II, and discusses the implications of these findings for the ongoing debate on regulatory networks. It examines additional hypotheses as to how TRNs might become more effective despite their limitations, but finds them insufficient to justify the more ambitious claims regarding the impact of TRNs on global governance. It also reviews the international relations literature on "soft law" and finds that, with some qualifications, it provides a useful starting point for a rationalist account of the strengths and weaknesses of TRNs. It also sounds cautionary notes about proposals to implement more formal administrative procedures to govern TRN rulemaking, as well as about the impact of public choice theory on the effectiveness and desirability of TRNs. The article concludes that, while TRNs are a useful means of regulatory policy coordination in certain circumstances, the more ambitious claims of their advocates are exaggerated. There are many paradoxes in global governance, and TRNs are but a modest part of the solution.

I. THE RISE OF REGULATORY NETWORKS

A. What Are Regulatory Networks?

The emergence of several major cooperation initiatives among national regulators began engaging the attention of international law scholars in the 1990s.[9] The Basel Committee had successfully adopted an international accord on bank capital adequacy in 1988, and efforts were underway to strengthen the rulemaking activity of IOSCO and IAIS.[10] Networks of environmental and antitrust regulators were also cited to illustrate an emerging global trend towards soft law and informal regulatory cooperation.[11] Early commentators expressed concern that these initiatives evidenced a shift towards disaggregated global governance by experts acting outside the constraints of domestic political structures and the normal foreign affairs process.[12]

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[9] The theory of TRNs finds its intellectual roots in the "transgovernmental relations" approach pioneered by political scientists Robert Keohane and Joseph Nye in the 1970s, and its insight that many direct interactions between governmental entities in different countries were not closely supervised and controlled by the highest executive and foreign relations functions. *See, e.g.*, Robert O. Keohane & Joseph S. Nye, *Transgovernmental Relations and International Organizations*, 27 WORLD POL. 39 (1974); ROBERT O. KEOHANE & JOSEPH S. NYE, POWER AND INTERDEPENDENCE: WORLD POLITICS IN TRANSITION (1977).

[10] *See, e.g.,* Zaring, *supra* note 5 (describing these three networks); Raustiala, *supra* note 5, 28-35 (discussing IOSCO).

[11] *See, e.g.*, Raustiala, *id*. at 43-49.

[12] *See* Sol Picciotto, *Networks in International Economic Integration: Fragmented States and the Dilemmas of Neo-Liberalism*, 17 NW. J. INT'L L. & BUS. 1014 (1996-97); Philip Alston, *The Myopia of the Handmaidens: International Lawyers and Globalization*, 8 EUR. J. INT'L L. 435 (1997); David Kennedy, *The Politics of the Invisible College: International Governance and the Politics of Expertise*, 5 EUR. HUM. RIGHTS L. REV. 463 (2001); David Kennedy, *Challenging Expert Rule: The Politics of Global Governance*, 27 SYDNEY J. INT'L L. 5 (2005).

Later, scholars such as Kal Raustiala and David Zaring proposed a more detailed account of TRNs, identifying several important networks and their principal characteristics and purposes.[13] Unlike formal international organizations created by treaty, TRN members are not states but national regulatory agencies, and they have no international legal personality or status beyond that conferred by their organization under national law.[14] They tend to operate by consensus without formal voting procedures, their membership is selective, and despite recent efforts at greater transparency, many of their important meetings and negotiations are kept secret until the resulting document is released.[15] Most importantly, the guidelines and other documents they promulgate have no international legal status, *i.e.*, they do not create obligations at international law and do not require the same cumbersome domestic ratification procedures as treaties. Finally, the networks do not formally monitor the implementation of their decisions or provide dispute-resolution procedures.[16]

Although no single definition of TRNs has emerged, Raustiala and Zaring's list of characteristics circumscribes the phenomenon with sufficient precision. In addition to this descriptive work, they developed tentative functionalist accounts of the emergence of TRNs in world affairs. Raustiala argued that the disaggregation of the state through direct international cooperation among national regulatory agencies was a logical response to changes in the regulatory environment brought about by technological innovation, the expansion of domestic regulation, and economic globalization.[17] Zaring also gave a largely positive account of TRNs, while noting the concern that regulators might use networks to free themselves from domestic constraints and pursue self-regarding aims.[18] Likewise, most other network theorists argue that TRNs can provide a forum to resolve highly technical issues of international regulation without the politicization associated with formal international organizations.[19]

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[13] *See* Raustiala, *supra* note 5; Zaring, *supra* note 5; *see also* David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547, 569-72 (2004-05); SLAUGHTER, *supra* note 5 at 48.
[14] *See* Zaring, *supra* note 5 at 301-02.
[15] *Id.* at 303.
[16] *Id.* at 303-04.
[17] *See* Raustiala, *id.* at 10-16.
[18] *See* Zaring, *supra* note 5 at 326-27.
[19] *Id.* at 286; Raustiala, *supra* note 5 at 24. While these authors point out that the networks' insulation from politics may be exaggerated, they do not explore the implications of that observation. Other commentators appear to assume that the networks' expertise and focus on technical regulatory issues insulates them from politics: *see, e.g.*, Jenia Iontcheva Turner, *Transnational Networks and International Criminal Justice*, 105 MICH. L. REV. 985, 992 (2006-07); Christopher A. Whytock, *A Rational Design Theory of Transgovernmentalism: The Case of E.U.-U.S. Merger Review Cooperation*, 23 B.U. INT'L L.J. 1, 30 (2005). Critics of the contemporary international order point to the fundamentally political nature of TRNs and their debates: *see, e.g.*, Picciotto, *supra* note 12 at 1037. The structural orientation of their critique, however, precludes detailed examination of the specific impact of politics on the effectiveness of networks. As will be seen below, Slaughter addresses political issues in more detail: *see* SLAUGHTER, *supra* note 5, ch. 6.

B. Networks and Global Governance: The Slaughter Claim

More recently, this earlier work has given way to an ambitious normative defense of TRNs as a privileged instrument of global governance. Thus, in *A New World Order,* Anne-Marie Slaughter argues that networks can solve the "paradox of global governance." On the one hand, globalization creates collective problems—global markets, weapons of mass destruction, environmental threats—that "can only be addressed on a global scale."[20] On the other, world government is "both infeasible and undesirable": not only would it inevitably fail to provide meaningful democratic representation, it would also ultimately threaten individual freedoms.[21] This paradox threatens to leave the world without effective institutional mechanisms to address a host of transnational problems, except at the price of sacrificing democratic accountability.

Slaughter claims that TRNs solve this paradox. Unlike formal international institutions that are often paralyzed by politics, TRNs have the advantages of speed, flexibility and inclusiveness, and the capacity to dedicate sustained attention to complex regulatory problems.[22] Once TRNs adopt rules, the domestic implementation efforts by national regulators lend them "hard power" and make them effective.[23] Therefore, TRNs can effectively address many of the collective problems caused by globalization. However, because they are "decentralized and dispersed, incapable of exercising centralized coercive authority," they do not raise the same democratic concerns as would a centralized world government.[24] Moreover, because their members are government actors, TRNs are ultimately accountable to their constituencies. From the standpoint of democratic theory, they are clearly preferable to amorphous and unaccountable "global policy networks" that bring together governments and private actors such as corporations and NGOs.[25]

TRNs, in sum, solve the "paradox of global governance" because they "expand our global governance capacity without centralizing policy-making power."[26] It is no surprise, according to Slaughter, that regulatory networks have proliferated in recent years.[27] Beyond striving towards policy convergence in their respective domains, they

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[20] SLAUGHTER, *supra* note 5 at 8.
[21] *Id*.
[22] SLAUGHTER, *supra* note 5 at 167; *see also* Raustiala, *id.* at 24-26.
[23] SLAUGHTER, *id.* at 168-69, 185.
[24] *Id.* at 11.
[25] *Id.* at 9-10.
[26] *Id*. at 167; *see also* Raustiala, *supra* note 5 at 51.
[27] Importantly, Slaughter's theory encompasses not only networks of national regulators, but also networks of judges and legislators. Given the many important differences she describes in the dynamics and structure of various types of networks, no critique of *A New World Order* could be complete without addressing such networks as the British Commonwealth or the complex relationship between the European Court of Justice, the European Court of Human Rights, and the domestic courts of each system's member states. This article does not propose such a comprehensive critique; my argument is limited to Slaughter's examination of *regulatory* networks and whether it supports her general theory of global governance through government networks. Likewise, it is limited to what she dubs "horizontal networks" of regulators from different countries cooperating across borders, by contrast with "vertical networks" involving the hierarchical implementation of rules developed by international organization.

also play an important role by producing and disseminating policy-relevant information and providing a framework for enforcement cooperation.[28] More generally, TRNs promote repeated interaction among national regulators, creating patterns of shared expectations and trust that facilitate future cooperation.[29] This, however, is not enough: Slaughter goes well beyond the detached functionalist account of TRNs and unreservedly advocates their active development. TRNs, in her view, are "a key feature of world order in the twenty-first century, but they are unappreciated, undersupported, and underused to address the central problems of global governance."[30] Instead, she claims, they should be "embraced" as "the architecture of a new world order."[31]

C. Three Limitations of Network Scholarship

While the existing literature on TRNs adequately identifies the phenomenon and many of its potential benefits and concerns, developing a systematic account that synthesizes these findings and incorporates them within a normative vision of global governance has proved challenging. This article argues that Slaughter's attempt to develop such an account suffers from three limitations that are symptomatic of important blind spots in TRN scholarship more generally.

First, Slaughter's claim that TRNs are intrinsically more accountable than global policy networks, while probably accurate, fails to specifically account for the mechanisms that generate such accountability. What is meant, presumably, is that the domestic legal and political mechanisms that normally hold national regulators accountable to their constituencies continue to apply when regulators participate in TRNs. This hypothesis, however, raises the question whether these mechanisms, which are designed to control domestic regulation, operate as intended in the context of international regulatory cooperation. Even if they do, the issue is not merely whether TRNs are "accountable" in some abstract sense, but *to whom* they are accountable. Thus, even if existing accountability mechanisms are effective, it is crucial to realize that they inevitably anchor national regulators to the demands of domestic constituencies, rather than those of a "hypothetical global polity."[32]

Second, if the incentive and accountability mechanisms that shape the behavior of national regulators bind them to domestic interests, then TRN rulemaking will succeed only when such interests are in harmony with the needs of global public policy. This would be true, for instance, if most international regulatory problems faced by TRNs involved simple coordination games. There is little reason, however, to assume that this is the case. If, on the contrary, international regulatory cooperation involves distributive and enforcement problems, prevailing domestic interests in different states may clash

[28] Slaughter categorizes regulatory networks, based on their activities, as "information networks" (focused on the exchange of information, ideas and best practices), "enforcement networks" (through which regulators cooperate to enforce their laws), and "harmonization networks" (which adopt common regulatory standards or procedures). *See* SLAUGHTER, *supra* note 5 at 51-61.
[29] *Id.* at 3.
[30] SLAUGHTER, *id.* at 1.
[31] *Id.* at 213.
[32] SLAUGHTER, *supra* note 5 at 29.

over alternative rules and resist compliance. There is substantial international relations literature on the ways in which states can structure international agreements and institutions to overcome such problems.[33] The networks literature, however, has not drawn substantially on this scholarship to assess whether and how TRNs can produce effective cooperation when faced with these more contentious regulatory issues.[34]

Third, by focusing on how TRNs can be made more responsive to the needs of their ultimate constituencies and of developing countries, Slaughter implicitly assumes—along with other network theorists—that they are real and effective *situs* of power. Paradoxically, very little attention has been devoted to the actual achievements and limitations of regulatory networks, and the conditions under which they are likely to be effective. Much of the discussion of actual network activity is descriptive—regulators established a network, discussed regulatory policies, and issued statements.[35] As Kenneth Anderson points out, however, we cannot assume that this means these networks have been successful, because "unfortunately this is also precisely the procedure followed when networks create *unsuccessful* outcomes."[36] A meaningful debate over the promise and perils of TRNs cannot proceed much further without some tentative evaluation of their effectiveness in solving concrete international regulatory problems.[37] This article attempts to address these limitations.

II. NETWORKS AND INTERNATIONAL REGULATORY COOPERATION: CONSTRAINTS AND CHALLENGES

This Part attempts to address the first two limitations of network scholarship described above. It does so, first, by drawing on international relations theory to define the concept of international regulatory cooperation and explain the challenges posed by distributive and enforcement problems in international regulatory matters. Second, it describes the multifaceted domestic constraints, both legal and political, that bind national regulators to the demands of domestic constituencies and argues that these constraints, along with other distinctive characteristics of TRNs, impair their effectiveness in addressing distributive and enforcement problems. This discussion will lay the groundwork for examining three specific case studies of the effectiveness of international regulatory cooperation through TRNs.

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[33] *See infra*, Part II.A.
[34] Slaughter does suggest that TRNs are not meant to replace traditional international institutions, but rather to exist alongside them, sometimes facilitating their work. *See id*. at 10, 18-19, 32. She does not, however, give a systematic account of the circumstances under which network cooperation is to be preferred over TRNs and vice versa.
[35] This point is eloquently made by Kenneth Anderson, *Squaring the Circle? Reconciling Sovereignty and Global Governance through Global Government Networks*, 118 HARV. L. REV. 1255, 1277-78 (2005) (reviewing ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER (2004)).
[36] *Id*. at 1278 (emphasis in original).
[37] This is not to say that network theorists have given no thought to these issues. Raustiala, for instance, recognizes that there are limits to network cooperation: "while networks can do much, they cannot, given their informal and flexible nature, achieve everything that regulators might desire or even what a strong multilateral agreement could." Raustiala, *supra* note 5 at 50. This recognition, however, takes the form of general disclaimers rather than a substantive exploration of the kind of factors cited above.

A. International Regulatory Cooperation

Robert Keohane states that "intergovernmental cooperation takes place when the policies actually followed by one government are regarded by its partners as facilitating realization of their own objectives, as the result of a process of policy coordination."[38] This broad definition encompasses phenomena as diverse as states allying against a common threat, choosing uniform telecommunication protocols, and harmonizing their business laws. More importantly, it also applies to a range of possible configurations of state capabilities and interests that make it more or less difficult in given circumstances to achieve and sustain international cooperation. These obstacles to cooperation are most visible in dramatic areas of "high politics" such as nuclear deterrence, arms control or alliance formation. They are, however, no less present in more technical areas of international regulatory cooperation such as securities law, banking and antitrust.

At one end of the spectrum are what, in the language of game theory, are referred to as "pure coordination games." In such situations, states share a common interest in coordinating their actions. The classic example is driving rules. Individual states may require automobile drivers to drive on the right or left side of the road. Assuming that no state has made preexisting investments in infrastructure, each state is indifferent between the two rules. All states, however, share an interest in coordinating their rules.[39] One important feature of pure coordination games is that the optimal outcome is self-sustaining—that is, once coordination is achieved, states lack incentives to deviate from the rule. As a result, coordination does not generally require extensive institutional monitoring and enforcement mechanisms, but can be achieved through simple agreement.[40] The agreement need not be binding at international law, as long as it allows each state to anticipate the other's actions and reach its own decision accordingly. Thus, pure coordination problems seem particularly amenable to resolution through informal, non-binding mechanisms such as regulatory networks.

This kind of situation is not uncommon in the international regulatory context. Consider the case of a transnational cartel involving enterprises located in two states. The cartel is illegal in both states and, in fact, each state would benefit from eliminating it

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[38] ROBERT O. KEOHANE, AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY 51-52 (1984).

[39] The pure coordination game is illustrated by the following payoff matrix:

State B

		Left	**Right**
State A	**Left**	1,1	0,0
	Right	0,0	1,1

Figure 1: Pure Coordination Game

[40] *See* Arthur A. Stein, *Coordination and Cooperation: Regimes in an Anarchic World in* INTERNATIONAL REGIMES 115, 125 (Stephen D. Krasner ed. 1983).

because it imposes net social costs on its residents.[41] In the absence of cooperation between regulatory authorities, however, the cartel members can arrange their affairs so that they cannot be effectively investigated and prosecuted. Some of the witnesses and evidence may be located in each state, with none having enough to form a complete picture of the conspiracy. The conspirators may respond to enforcement action in one state by moving some of their activities or evidence to the other. Even if prosecution succeeds in one state, its judgments in antitrust matters may not be enforceable in the other's courts. In such a case, each state clearly benefits from coordinating its enforcement procedures with the other. They may, for example, adopt agreements providing for mutual assistance in obtaining evidence and compelling witnesses; consultations between prosecutors to coordinate the timing of their investigations; and recognition of judgments rendered by the other's courts. Once the agreements are adopted, prosecutors will be able to rely on them to fight transnational cartels.

As will be seen below, one would expect TRNs to be successful in achieving this kind of procedural coordination of enforcement efforts. There are, however, two important categories of problems that may hinder international cooperation efforts and that are not captured by the pure coordination game: distributive problems and enforcement problems. First, *distributive problems* arise when "there are multiple self-enforcing agreements or outcomes that two or more parties would all prefer to no agreement, but the parties disagree in their ranking of the mutually preferable agreements."[42] In game theory, this situation is often illustrated by the so-called "Battle of the Sexes." In this game, a husband and wife have to choose between attending a boxing match or the ballet. In line with time-honored stereotypes, the husband prefers the former, the wife the latter. Crucially, however, both would prefer attending the same event over attending his or her preferred event alone.[43]

In the regulatory context, distributive problems frequently arise when states attempt to harmonize their domestic rules to a global standard, because states often have divergent preferences regarding what the global standard should be. To build on the preceding example, suppose that states wished to go beyond coordinating their antitrust enforcement procedures and harmonize all or part of their substantive laws. This might involve adopting common rules and definitions to determine under what conditions certain controversial competitive practices—for instance, agreements between manufacturers and their distributors to set a single retail price for merchandise, or to allocate market segments or regions to specific distributors—would be deemed illegal.

[41] That is, it increases the prices charged to consumers in each state sufficiently to outweigh any benefits accruing to the participating producers in that state.
[42] James Fearon, *Bargaining, Enforcement, and International Cooperation*, 52 INT'L ORG. 269, 274 (1998).
[43] The resulting payoff matrix is illustrated below:

		State B	
		Language A	**Language B**
State A	**Language A**	2,1	0,0
	Language B	0,0	1,2

Figure 2: Battle of the Sexes

Even if states agree that a common standard would benefit all, each state might prefer a different standard—presumably one closer to its existing law and the practices of its important domestic industries.

These distributive implications make cooperation harder to attain, because each state may attempt to "hold out" at the negotiation stage in the hope that the other will settle for its preferred outcome.[44] Distributive obstacles to international cooperation are often solved through side payments; that is, if the costs and benefits of each alternative rule can reliably be estimated, the "winner" states may agree *ex ante* to compensate the "loser" states to induce them to adopt their preferred solution. These side payments may take a variety of forms, from cash payments to an agreement to follow the other state's preferred rule in a different area of international cooperation. Alternatively, if states lack sufficient information to estimate the relative costs and benefits of each rule, they may build flexibility provisions that allow the agreement to be renegotiated after some time has elapsed and the distributive effects are revealed.[45] Powerful states may simply use their clout to steer others toward their preferred outcome by threatening unilateral action.[46] Once attained, cooperation may be self-sustaining without the need for elaborate institutional mechanisms such as monitoring, dispute resolution or enforcement mechanisms.[47]

In contrast, *enforcement problems* arise once an agreement has been reached because individual states have incentives to renege on the agreed rules to pursue short-term benefits. This risk of opportunistic defection is frequently illustrated in game theory by reference to the Prisoners' Dilemma.[48] In essence, the answer to the cooperation problem posed by the Prisoners' Dilemma lies in the dynamics created by repeated iterations of the game. If both states know that the game will be repeated indefinitely and

[44] *See* Fearon, *supra* note 42.
[45] *See* James D. Morrow, *Modeling the Forms of International Cooperation: Distribution versus Information*, 48 INT'L ORG. 387 (1994); Barbara Koremenos, *Loosening the Ties that Bind: A Learning Model of Agreement Flexibility*, 55 INT'L ORG. 289 (2001); Barbara Koremenos, *Contracting around International Uncertainty*, 99 AM. POL. SCI. REV. 549 (2005).
[46] *See* Stephen D. Krasner, *Global Communications and National Power: Life on the Pareto Frontier*, 43 WORLD POLITICS 336 (1991).
[47] *See* Arthur A. Stein, *Coordination and Collaboration: Regimes in an Anarchic World*, *in* INTERNATIONAL REGIMES, *supra* note 40 at 115, 125-27, 129-30.
[48] The "prisoner's dilemma" is named after a scenario in which two prisoners are being interrogated separately by the police. If none confess, they will both receive a light sentence; if only one confesses, he will be released and his confession will be used to secure a life sentence against the other; if both confess, they will both receive a heavy sentence, but short of life imprisonment. No matter what the other does, each prisoner is better off confessing. The result is that both confess and receive heavy sentences. Both prisoners, however, would both have been better off if none had confessed and both had received light sentences. The Prisoners' Dilemma is illustrated by the following payoff matrix:

		State B	
		Cooperate	**Defect**
State A	**Cooperate**	3,3	1,4
	Defect	4,1	2,2

Figure 3: Prisoner's Dilemma

care enough about future gains (*i.e.*, they have a low discount rate), they may develop retaliation strategies that will provide mutual incentives to cooperate and attain the Pareto optimal outcome.[49] The success of these strategies depends on several conditions, including the availability to participants of reliable information regarding defections by others; their capacity to credibly threaten retaliation; and self-restraint, as excessive retaliation strategies can also disrupt cooperation.

In such cases, institutional mechanisms can play a central role in facilitating cooperation. An often-cited example is the international trade regime, in which each state benefits from the cooperative outcome in which all states open their markets, but each state would prefer to defect by erecting barriers to trade while others liberalize. Importantly, the WTO does not include a central enforcement mechanism that would directly apply sanctions to states that violated trade rules. Instead, enforcement comes in the form of countermeasures by individual states. Nevertheless, the WTO plays a central role in facilitating maintenance of the cooperative outcome. It facilitates the negotiation of clear rules identifying the expected cooperative behavior; it periodically reviews its members' trade policies for possible violations of global rules; it provides an impartial dispute-resolution mechanism to authoritatively identify defections; and it incorporates a detailed legal regime of countermeasures that limits response by aggrieved states to what is necessary and proportionate.

It is important to realize that distributive and enforcement problems are not mutually exclusive: a single international regime may involve both these problems at various stages. When negotiating, states may have difficulty coordinating on a single set of rules if distributive considerations lead them to prefer different outcomes. At this stage, one is likely to observe reciprocal concessions and the exercise of power to secure a state's preferred outcome. Once an agreement is reached, the focus will turn to compliance and enforcement. If states have no incentives to deviate from the agreement, collaboration will likely be self-sustaining. If, however, states have incentives to cheat, the factors that facilitate or hinder cooperation in an iterated Prisoner's Dilemma will take center stage. Both problems may also interact. For instance, James Fearon has argued that, while a low discount rate facilitates cooperation once an agreement is reached, it also raises the distributive stakes of the agreement and makes the initial negotiations more difficult and likely to fail.[50]

B. TRNs and Domestic Accountability Structures

National regulators are not, in Anderson's words, "masterless *ronin*."[51] They are politically accountable to myriad domestic constituencies—including not only their superiors in the executive branch but also the legislature, the courts, the media and the public. This section describes in some detail the principal domestic accountability and incentive structures that shape the actions of national regulators. It also discusses the

[49] *See* ROBERT AXELROD, THE EVOLUTION OF COOPERATION (1984).
[50] *See* Fearon, *supra* note 44.
[51] Anderson, *supra* note 35 at 1296.

effect of these structures on the capacity of TRNs to effectively address international regulatory issues, especially when they involve distributive or enforcement problems.

1. Political Constraints

Modern regulatory agencies are often designed to secure some degree of independence from the executive and legislative branches. Nevertheless, politicians exercise significant influence over the administrative process. Senior appointments are typically made by the executive, and in some constitutional systems, they also require approval by the legislature. These appointments are often political in nature, and agency heads retain "special ties" with senior political figures.[52] Legislative bodies typically exercise supervisory authority over regulatory agencies, holding periodic hearings and reviewing budgets and appropriations.[53] In some instances, regulated entities and other concerned parties succeed in convincing legislators to override agency rules through special laws.

As a result, politicians may intervene through several channels to prevent or override adoption of international standards that would threaten their reelection prospects or other political objectives. They may also steer the international regulatory agenda towards politically-salient issues that regulators would not otherwise treat as priorities. Even without direct intervention, agency activities are constrained by the possibility of such intervention. In other words, while regulators exercise some discretion in both their domestic and international actions, they do so in the shadow of the executive and legislature's views and interests. This fact is well-recognized in the political science literature, which often models agency behavior on the basis that bureaucrats' discretion is bounded by the possibility of legislative intervention.[54]

Importantly, not all regulators are created equal in this respect. They benefit from various degrees of autonomy within the domestic political system, ranging from largely independent bodies such as the U.S. Federal Reserve, through expert agencies with substantial independence like the SEC and the FTC, to executive branch functions, like the Antitrust Division of the U.S. Department of Justice. While the degree of autonomy possessed by a specific regulator is hard to measure, important factors include length and security of tenure for senior appointments, autonomous funding sources, judicial review standards, and the relative political strength of other domestic actors. Thus, which regulator has jurisdiction over a given issue-area in a given country is likely a significant factor in the success or failure of a TRN.[55] The significant discrepancies in regulatory

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[52] *See* Peter L. Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573, 589-91 (1984).
[53] Some agencies may, however, benefit from autonomous funding. For instance, the Federal Reserve is funded by interest on its security holdings, and the OCC by bank examination fees. *See* Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 EUR. J. INT'L L. 15, 18 (2006).
[54] *See, e.g.*, David A. Singer, *Capital Rules: The Domestic Politics of International Regulatory Harmonization*, 58 INT'L ORG. 531, 535-38 (2004).
[55] *See* Mark A. Pollack & Gregory C. Shaffer, *Who Governs? in* TRANSATLANTIC GOVERNANCE IN THE GLOBAL ECONOMY 287, 298, 302-03 (Mark A. Pollack & Gregory C. Shaffer eds. 2001); Whytock, *supra* note 19 at 31.

independence between countries may themselves hinder agreement. Even a powerful and independent regulator like the Federal Reserve might hesitate to commit itself to a demanding international standard if it suspects that some of its foreign counterparts would be unable to resist domestic political pressures to breach it.

In addition to these direct political constraints, regulators are typically subject to administrative law requirements to open their proposed standards to public scrutiny and comment.[56] This process allows regulated industries, the media and the public to play a role in the rulemaking process. While it is generally seen as beneficial in domestic regulatory contexts, its duplication in multiple countries as regulators attempt to develop and implement common rules is likely to cause significant delays and may derail the entire effort. Finally, once adopted, the standards are subject to judicial review under substantive and procedural standards. While courts typically allow expert regulators broad discretion to adopt standards and policies, the possibility of complex regulatory standards being struck down by the courts is real, as illustrated by the SEC's ill-fated hedge fund rule.[57] The looming possibility of judicial review limits the ability of regulators to credibly commit themselves to international rules, thus limiting the potential for such rules to sustain optimal outcomes in cooperation games.

2. Legal Constraints

A crucial and little-discussed limitation on the effectiveness of TRNs is the array of domestic legal constraints they face in their efforts. National regulators participating in TRNs are subject to domestic legal limitations on their jurisdiction. Most obviously, when the regulatory standards they administer and enforce are statutory, they normally have no authority to modify them by agreement with foreign regulators. This reality circumscribes the set of international policies they can agree to. Even where the law gives regulators substantial discretion to elaborate substantive policies, it virtually always limits their authority to a specific issue-area. These jurisdictional boundaries limit the extent to which domestic regulators negotiating with their foreign counterparts can offer side payments to overcome distributional obstacles to an agreement, or link the agreement to existing enforcement mechanisms.[58] For example, since U.S. antitrust regulators have no authority over international trade policy, they cannot offer tariff concessions or foreign aid payments to convince other states to subscribe to their preferred harmonized antitrust rules. Likewise, they cannot on their own incorporate harmonized standards into the WTO agreements in order to benefit from its powerful dispute resolution and enforcement regimes.

In other cases, international cooperation may be further hindered by domestic jurisdictional rivalries between regulatory agencies. This tendency is most apparent in the United States, where major areas of economic regulation—such as banking, securities

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[56] In the United States, the *Administrative Procedure Act* governs their rule-making activities by requiring them to give public notice of proposed rules and consider public comments before issuing a final rule. APA 553.
[57] *See* Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006) (invalidating a hedge fund registration rule promulgated by the SEC as "arbitrary.")
[58] *See* Picciotto, *supra* note 12 at 1039.

and commodities, and antitrust—are parceled out between multiple federal and state regulators. As will be discussed below, the process leading to the adoption of the Basel II accord involved years of contentious negotiations, not only at the international level, but also between U.S. regulators, including the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation, federal thrift regulators, and state banking authorities. These problems may also arise in Europe, due to ongoing shifts in rulemaking and supervisory responsibilities between the European Commission, EU legislative institutions, the European Central Bank, and national regulators. Where such jurisdictional feuds prevail, international rulemaking by TRNs may reduce the odds of an effective outcome relative to negotiations between traditional foreign affairs departments empowered to override jurisdictional constraints on subordinate agencies.

3. Implications for TRNs

In sum, national regulators are subject to a range of domestic political and legal constraints that influence their behavior and effectiveness. These constraints clearly bind their actions to the demands and interests of domestic actors. In other words, national regulators, although they possess some discretion, are accountable to domestic constituencies through strong and identifiable ties, in stark contrast to their potential accountability to a "hypothetical global polity."[59] This suggests that, when domestic interests clash with international cooperation, national regulators will side with the former. If the negotiation of a global regulatory standard involves distributive issues, they will have incentives to hold out for their domestic constituents' preferred outcome. If domestic interests point toward reneging on a previously-agreed standard, they will be under pressure to abandon the rule or facilitate reneging by domestic actors. Crucially, as seen above, such clashes of interests do not invariably prevent international cooperation from emerging. It does, however, raise the question whether TRNs provide a suitable institutional framework for resolving distributive and enforcement problems. The theoretical considerations considered so far suggest a negative answer.

First, TRNs are likely to encounter substantial obstacles in any attempt to adopt common regulatory standards when the choice among possible standards has distributive implications for the states concerned. In such cases, the negotiation stage will be influenced by attempts by states to secure their preferred solution, either through bargaining or coercion. In the former case, however, the trade-offs that would be necessary to secure agreement to a proposed standard may not be within the domestic authority of regulators. Even if the negotiators had such authority, the informal, consensus-based procedures used by TRNs are not designed to facilitate the complex tradeoffs that may be required to reach agreement. Without the possibility of offering side payments in other issue-areas, regulators will be tempted to simply water down the proposed standards to make them acceptable to every participant without requiring tangible offsetting concessions. While they may produce the appearance of an agreement, such concessions may weaken the standard and compromise its effectiveness in achieving and sustaining international cooperation.

[59] SLAUGHTER, *supra* note 5 at 29.

Second, the incapacity of TRNs to provide credible commitment mechanisms is likely to cause significant difficulties in solving enforcement problems. While TRNs may deter some defections through reputational incentives, these fall short of the enforcement measures available in the context of formal treaties and institutions. Moreover, cooperation requires a sacrifice of short-term national interests that may not be within the legal authority or political capability of national regulators operating within domestic constraints. If courts or politicians can override regulators and their network standards when domestic considerations so dictate, the commitment will not be perceived as credible. These considerations indicate that the theoretical case for networks is much stronger in the absence of enforcement problems.[60] The resulting prediction is that, in areas where international regulatory cooperation raises enforcement problems, regulatory networks will either not be established, adopt shallow standards that provide few benefits and little incentives for states to defect, or their efforts will be hindered by defections.

Third, the possibility of coercion reveals that the negotiation process is likely to be profoundly affected by international power relationships. The existing literature recognizes as much by pointing to the disproportionate access and influence of powerful states in TRNs. It is necessary, however, to go beyond this general observation and attempt to identify the ways in which power relationships affect the dynamics of TRNs. At one extreme, powerful states may coerce others to participate in international regulatory efforts to which they would otherwise be opposed or indifferent. Even when coordination produces mutual benefits, powerful states may use incentives and threats to secure their preferred outcome. In such cases, even if the resulting standards are beneficial to all, powerful states will enjoy a disproportionate share of the benefits. By contrast, power disparities may be beneficial when participants face incentives to defect, because a powerful state with a strong stake in upholding the standards may voluntarily assume much of the monitoring and enforcement costs.

C. Choice of Case Studies

The following Parts of this article contain case studies of three TRNs: IOSCO, the Basel Committee on Banking Supervision and the ICN. The choice of these cases was guided by existing scholarship on TRNs, where they are almost universally cited as examples of successful regulatory networks.[61] There are several reasons why those

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[60] Anderson makes precisely this point when discussing the Y2K problem. *See* Anderson, *supra* note 35 at 1275-76 ("Y2K was not a matter in which policy would produce winners and losers—all would gain by cooperating. … Indeed, the success of global cooperation to address Y2K may have been due to the characteristics of the problem, rather than to anything about the networks created to solve it.")

[61] *See, e.g.*, Zaring, *supra* note 5 at 287-301 (discussing the Basel Committee, IOSCO and IAIS); Zaring, *supra* note 13 at 555-69 (discussing the Basel Committee and IOSCO); Anne-Marie Slaughter, *Governing the Global Economy through Government Networks* in THE ROLE OF LAW IN INTERNATIONAL POLITICS 177, 181-86 (Michael Byers ed. 2000) (discussing the Basel Committee, IOSCO and IAIS); Raustiala, *supra* note 5 at 28-35 (discussing IOSCO and regulatory cooperation in securities regulation), 35-43 (discussing regulatory cooperation in antitrust); SLAUGHTER, *supra* note 5, ch. 1 (referring to the Basel Committee, IOSCO and the Global Competition Network as leading examples of TRNs); Barr & Miller, *supra* note 53 at 17 ("It is fair to say that Basel I is one of the most successful international regulatory initiatives ever attempted. …The Basel Committee is perhaps the most important example of a transgovernmental regulatory network that exercises vast powers, seemingly without any form of democratic accountability.");

networks have come to occupy a salient position in the literature. All three of them deal with areas of economic regulation that are deeply affected by globalization. In response, the activities of both the Basel Committee and IOSCO have expanded rapidly since the beginning of the 1990s. The IOSCO now includes many developing country members, and while formal Basel Committee membership is limited to G-10 countries, the IMF and World Bank have incorporated its standards in their efforts to promote financial infrastructure improvements in the developing world. The ICN, while more recent, rapidly became a very active forum for international antitrust cooperation, while efforts to build competition rules into the WTO's Doha Round foundered. In addition, within the universe of TRNs, those three networks are relatively formal, producing a steady and increasing output of readily available documents, holding frequent meetings, and publicizing their activities through the Internet and in professional and academic fora. These factors have created an aura of apparent success around the Basel Committee, IOSCO and the ICN and ensured their prominence in TRN scholarship.

I have chosen those three TRNs as my case studies for the very reason that they are generally viewed as successful. A recurring difficulty concerning the use of case studies is selection bias, that is, the risk that the method used to choose the relevant observations may detrimentally affect the determinacy or reliability of the outcome.[62] The most obvious form of selection bias arises when researchers—consciously or not—select cases likely to vindicate their desired conclusion.[63] As a result, conclusions drawn from cases, while consistent with the researcher's theory, may not be representative of the broader social phenomenon that the theory purports to address. To avoid this difficulty, I have deliberately chosen the three cases that are most widely seen in TRN scholarship as the strongest examples of successful networks.[64] If anything, the selection of these cases is biased towards successful outcomes. In this light, if closer examination of these cases reveals limitations consistent with the theoretical argument developed above, it will be an indication that these limitations are intrinsic to the TRN form and not

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Turner, *supra* note 19 at 993 (mentioning Basel and IOSCO); Youri Devuyst, *Transatlantic Competition Relations* in TRANSATLANTIC GOVERNANCE IN THE GLOBAL ECONOMY 127 (Mark A. Pollack & Gregory C. Shaffer eds. 2001) (arguing that "transatlantic relations in the sphere of competition policy are a perfect example of what Anne-Marie Slaughter … has labeled a 'new transgovernmental order.'")

[62] *See* GARY KING, ROBERT O. KEOHANE AND SIDNEY VERBA, DESIGNING SOCIAL INQUIRY: SCIENTIFIC INFERENCE IN QUALITATIVE RESEARCH 128 (1994); JOHN GERRING, CASE STUDY RESEARCH: PRINCIPLES AND PRACTICES, ch. 5 (2007); David Collier & James Mahoney, *Insights and Pitfalls: Selection Bias in Qualitative Research*, 49 WORLD POLITICS 56 (1996).

[63] *Id.*

[64] There are, of course, several other global TRNs one might use as examples, but most of them, such as the International Association of Insurances Supervisors (IAIS), have been less active than these three examples and are not frequently cited as leading instances of successful network cooperation. Another frequently-cited global network is the International Network for Environmental Compliance and Enforcement, but its broad structure encompassing regulators, NGOs and international organizations makes it closer to the type of "global policy networks" criticized by Slaughter. One should also note that many important regulatory networks are embedded within the EU, particularly in the areas of banking and securities regulation and supervision. As subordinate and essentially facilitative bodies within the context of an authoritative political structure entrusted with the power to make and enforce rules binding on all member states, however, their role is fundamentally different from that of global TRNs. The same can be said, albeit to a lesser extent, of the North American environmental and labor regulatory networks created by formal agreements alongside NAFTA.

limited to its weakest or least successful incarnations.[65] Indeed, as will be seen, while proponents of TRNs propose a largely positive and optimistic assessment of the Basel Committee and IOSCO, experts in the relevant substantive regulatory areas are frequently critical of their achievements, while those of the ICN remain uncertain.

III. THE BASEL COMMITTEE ON BANKING SUPERVISION

The Basel Committee was established in 1974 by the governors of the central banks of the G-10 countries, plus Switzerland. It serves as an informal cooperation forum on issues of bank regulation and supervision. Although the Committee has initiated several regulatory cooperation efforts over the years, by far its most significant and well-known achievement is the 1988 Basel Accord on bank capital adequacy. The Accord, which sets uniform regulatory capital requirements for internationally active banks, has been adopted by some 120 countries including the United States, the European Union and Japan. The Accord is an informal understanding between national bank regulators, not a treaty. As a result, it does not bind any of the adopting states at international law, and is implemented by national regulators exercising their regulatory powers under domestic law.[66] The Basel Committee does not have any formal review, monitoring or enforcement mechanism.

This section analyzes the Basel Accord in light of the theoretical framework elaborated above. Whereas most of the literature on the Accord focuses on the events leading up to its adoption in 1988, this Part also discusses subsequent compliance with the Accord and the process leading to its successor, the 2004 Basel II Accord.[67] This analysis reveals that, although the Accord is often considered the "crown jewel" of international banking regulation,[68] its negotiation and implementation reflect the strong influence of domestic interests and the limitations of TRNs in securing compliance. The Accord, strongly supported by the U.S. and U.K.—whose international banks were mired in crisis following several emerging market defaults—was adopted against the objections of Japan and continental European jurisdictions. To secure adhesion, proponents of the

[65] A second form of selection bias is that which arises when the cases allow for insufficient variation on the dependent variable. *See* KING, KEOHANE AND VERBA, *supra* note 62 at 129; GERRING, *supra* note 62 at 97-101. In this study, the dependent variable is the effectiveness of TRNs, and as will be seen, the cases selected show significant variation both among the networks and between different issues addressed by the same network. Thus, this form of selection bias should not affect the conclusions drawn here.
[66] *See* Lawrence L.C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1 (1998-1999).
[67] *See* BASEL COMMITTEE ON BANKING SUPERVISION, BASEL II: INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK (Nov. 2005). A consolidated version incorporating earlier Basel Committee rules regarding capital requirements for market risk and other elements of the original framework that were not revised in Basel II, was released in 2006. *See* BASEL II: INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS: A REVISED FRAMEWORK - COMPREHENSIVE VERSION (Jun. 2006). During the 1990s, the Basel Committee shifted from using the French spelling "Basle" to the German "Basel." For the sake of consistency, I use the latter throughout, even when referring to documents published prior to the shift.
[68] *See* HAL S. SCOTT, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY AND REGULATION 306, 309 (13th ed. 2006). For the consolidated version of the original 1988 accord, reflecting amendments made between 1988 and 1998, *see* BASEL COMMITTEE ON BANKING SUPERVISION, INTERNATIONAL CONVERGENCE OF CAPITAL MEASUREMENT AND CAPITAL STANDARDS (Apr. 1998) [hereinafter the Basel Capital Accord].

Accord resorted both to coercive tactics, threatening to exclude noncompliant foreign banks from their markets, and to substantive tradeoffs that weakened the long-term effectiveness of the Accord. As time went on, national regulators began exploiting ambiguities in the Accord to secure a competitive advantage for their banks, a development that the Committee was largely powerless to counter.

A. Explaining the Basel Accord

What does the apparent success of the Basel Accord tell us about the effectiveness of international regulatory cooperation through TRNs? To answer this question, consider first the nature of the problem faced by national regulators when setting domestic capital adequacy standards. Functionalist accounts of the Basel Accord emphasize the common interest of national regulators in controlling the systemic risk associated with divergent national capital rules. In this view, the Basel Accord solves the collective action problem that arises because individual banks and their regulators have incentives to maintain suboptimal capital levels in order to improve their competitiveness.

A bank's capital functions as a cushion to absorb losses and avoid insolvency. Unlike in other industries, where companies routinely fail as a result of business losses, regulators impose capital adequacy requirements on banks. Two policy reasons are generally invoked to justify regulatory capital requirements. First, most jurisdictions protect depositors by providing deposit insurance and acting as lenders of last resort to prevent bank failures. While these policies promote confidence in the banking system, they also create moral hazard by reducing the incentives for depositors to monitor bank creditworthiness. Second, regulators are concerned that bank failures may reverberate through the financial system and, in extreme cases, paralyze the economy—a phenomenon known as systemic risk.[69] Regulatory capital requirements correct these market failures by forcing banks to maintain sufficient capital to absorb losses without becoming insolvent.[70]

In a globalized financial system, however, competition between states may undermine the effectiveness of domestic capital adequacy regulation. Individual countries stand to gain significant benefits by attracting banking activity within their jurisdiction. International banking produces sizeable tax income, high-paying and highly-skilled employment and financial infrastructure that supports local economic growth.[71] Thus, when setting its level of capital regulation, each country has incentives

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[69] Bank failures may spread to other banks through the payment system, short-term loans, off-balance sheet exposures such as swaps and other derivatives, and imitative bank runs. While recent improvements to payment systems and clearing and settlement systems have reduced the risk that they might transmit financial shocks, regulators remain concerned about systemic risk. *See* SCOTT, *supra* note 68 at __ (explaining that the payment and overnight loan systems are less likely than before to transmit shocks).
[70] On this and other functions of bank capital, *see* DUNCAN WOOD, GOVERNING GLOBAL BANKING 72-73 (2005).
[71] For instance, the United Kingdom is arguably the world's premier international banking center, with a large financial industry largely oriented towards the provision of cross-border services. In 2007, the British Bankers' Association reported that banking and financial services accounted for £70bn of the United Kingdom's national output (6.8% of GDP), employed over 1.1 million people, and provided 25% of total

to weigh the benefits of greater financial stability against those of attracting banking activity from abroad. This is likely to result in capital levels that are lower than the level which would prevail in the absence of regulatory competition. In other words, autonomous rule-making on bank capital by national authorities is feared to lead to a "race to the bottom," that is, inefficient lowering of the regulatory standards in each country.[72]

The functionalist account holds, in essence, that over the 1980s bank regulators around the world became aware of the systemic risks associated with bank lending.[73] This "consensual knowledge" was produced by events such as the failures of Bankhaus Herstatt and Franklin National Bank (1974) and the massive bank losses produced by the Latin American debt crisis (1982). The rise of systemic risk in international banking created a demand for collective action in the form of uniform bank capital rules, a demand fulfilled by the adoption of the 1988 Accord. Indeed, the primary objective of the 1988 Accord was to create a "level playing field" in international banking by preventing countries with lower capital requirements from acquiring a disproportionate share of business.[74] Recent research on the Basel Accord, however, has been more skeptical of the functionalist hypothesis and supplements it by looking to domestic politics as a primary factor in the demand by certain regulators for international regulatory cooperation.[75] The following section examines the adoption of the Basel Accord and its subsequent compliance record in light of this research.

B. The Basel Experience: Adoption and Compliance

1. The Negotiation Stage

The functionalist account of the Basel Accord has been criticized for failing to recognize the depth and significance of the discrepancies between the objectives of U.S. and U.K. bank regulators, who strongly favored the Accord, and those of authorities in Japan, Germany and France, who opposed it.[76] If global demand for a solution to the collective action problem posed by systemic risk is taken as the primary explanatory factor behind the Accord, the stark opposition between these two groups of regulators cannot easily be explained.

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corporation tax (£8bn) to the UK government. *See* British Bankers' Association, Top Ten Industry Facts (Apr. 5, 2007), *available at* http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=469&a=7447.

[72] *See* WOOD, *supra* note 70 at 9.

[73] *See* Ethan B. Kapstein, *Resolving the Regulator's Dilemma: International Coordination of Banking Regulations*, 43 INT'L ORG. 323 (1989); *see also* RICHARD J. HERRING & ROBERT E. LITAN, FINANCIAL REGULATION IN THE GLOBAL ECONOMY (1995); Frederic S. Mishkin, *Prudential Supervision: Why Is It Important and What Are the Issues?*, *in* PRUDENTIAL SUPERVISION: WHAT WORKS AND WHAT DOESN'T 1 (Frederic S. Mishkin ed. 2001).

[74] *See* JOSEPH J. NORTON, DEVISING INTERNATIONAL BANK SUPERVISORY STANDARDS 33-36 (1995); SCOTT, *supra* note 68 at __; Heath Price Tarbert, *Rethinking Capital Adequacy: The Basle Accord and the New Framework*, 56 BUS. LAW. 767, 784 (2001).

[75] *See* Thomas Oatley & Robert Nabors, *Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord*, 52 INT'L ORG. 35 (1998); Singer, *supra* note 54; DAVID A. SINGER, REGULATING CAPITAL: SETTING STANDARDS FOR THE INTERNATIONAL FINANCIAL SYSTEM (2007).

[76] *See* Oatley & Nabors, *id.* at 46-48; Singer, *id.* at 550.

In response, David Singer develops a model which national regulators are the primary actors, constrained by the need to avoid legislative intervention. Legislatures, in turn, are driven by two competing considerations: maintaining confidence in the financial system, on the one hand, and preserving the international competitiveness of the country's financial institutions. This creates a situation in which regulators effectively have discretion to set regulatory policy within a "win-set" defined by the risk of legislative intervention, which will occur if regulation is too lenient (thus threatening financial stability) or too stringent (thus undermining competitiveness). Exogenous shocks may create demand for more stringent regulation to which regulators must respond to avoid legislative intervention. By bolstering regulatory standards unilaterally, however, regulators run the risk that domestic institutions will become less competitive and lobby the legislature to intervene. They can avoid this result if, instead of acting unilaterally, they push for the adoption of uniform international regulatory standards that will preserve the competitive position of their institutions. Thus, domestic factors explain the demand by particular states for international regulatory cooperation.

Within this theoretical framework, the debate surrounding the adoption of the Basel Capital Accord may be explained. The 1982 sovereign debt crisis had ushered in an era of severe financial difficulties for major U.S. banks. In 1982, U.S. bank loans to Mexico, Brazil and Argentina amounted to more than 140% of the capital of the nation's nine largest banks.[77] As a result, the debt crisis threatened the solvency of several major institutions and the stability of the U.S. financial system. The regulatory response was to implement stricter regulatory capital standards to prevent future crises; however, it became clear that unilateral adoption of such standards would jeopardize the competitiveness of U.S. banks in international markets. Starting in the mid-1980s, the United States proposed the adoption of uniform international capital standards, which would allow it to raise its own capital standards while preserving a "level playing field" in international banking.[78]

The proposal was resisted by several countries, including major financial centers such as Japan and Germany. Japanese banks, in particular, had been much less involved in LDC lending than their counterparts in the U.S. and U.K. Due to their size and their close relationships with politicians and regulators, they also benefited from a market perception of a much stronger government safety net to prevent bank failures, through direct intervention if necessary. As a result, lower capital levels were needed to sustain market confidence in their stability, and these lower levels in turn increased their competitiveness as they rapidly expanded their international operations.[79] While German and other European regulators supported capital regulation in principle, they argued that their unique banking structure—including substantial corporate equity holdings by banks—made uniform rules inappropriate. Their exposure to LDCs was also much less than in the U.S. and U.K.

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[77] *See* Oatley & Nabors, *id.* at 42.
[78] *See* WOLFGANG REINICKE, GLOBAL PUBLIC POLICY: GOVERNING WITHOUT GOVERNMENT? 108-09 (1998).
[79] *See* SINGER, *supra* note 75 at 59-60.

A breakthrough occurred in January 1987, when the United States and the United Kingdom announced a bilateral accord on capital adequacy. The two countries then initiated further talks with Japan and Germany, backed by the implicit threat that they would restrict access to their markets by banks from countries that did not implement the new capital adequacy standards.[80] The resulting negotiations led to the adoption of the Basel Capital Accord in 1988. In essence, the Accord includes a definition of regulatory capital and a risk-weighting formula designed to determine how much capital a bank must maintain given the size and riskiness of its investments. The global capital standards advocated by the United States and the United Kingdom were clearly perceived as producing unequal gains for the potential participants. In particular, Japan and Germany resisted the bilateral accord's definition of capital, which did not include holdings of corporate equities, traditionally an important class of Japanese and German bank assets. Japanese banks also had large unrealized gains on securities and real estate, which their country wished to see included in regulatory capital.

In Singer's view, the debate surrounding the Accord reveal the importance of domestic factors in determining the demand for international rules. Thus, U.S. and U.K. regulators faced with an exogenous shock to confidence in their financial institutions had to increase their regulatory capital requirements. In order, however, to avoid impairing the international competitiveness of their bank, they also strove for these requirements to be adopted internationally so that they would also apply to foreign banks. Given this demand, adoption of the Accord over the resistance of other countries was simply a function of relative power: at that time, the dominance of U.S. and U.K. financial markets was such that the threat to exclude noncompliant foreign banks from their markets was sufficient to overcome countervailing interests.[81]

This account of the Accord's adoption is consistent with the idea that the actions of national regulators in TRNs are driven primarily by domestic pressures. This is unsurprising, given the strong domestic accountability structures described earlier. However, while the United States and the United Kingdom clearly leveraged their relative power in international finance to push the recalcitrant countries towards an agreement, it is notable that the Basel Accord contained significant concessions to the domestic economic and political interests of Japan and Germany. One notes that these concessions came, not in the form of side payments, but of substantive tradeoffs within the provisions of the Accord itself.

For instance, the final Accord did not commit national regulators to apply the new capital standards to all banks, but only to internationally active ones. While the United States and the United Kingdom applied the rules to all their banks, Japanese regulators only applied them to a small number of international banks.[82] Likewise, the Accord split regulatory capital into two "tiers" and provided significant flexibility for national regulators to recognize various assets—such as unrealized gains on securities in real estate and subordinated debt—as regulatory capital.[83] National regulators also retained

[80] *See* REINICKE, *supra* note 78 at 109-10.
[81] *See* SINGER, *supra* note 75 at 61.
[82] *See* WOOD, *supra* note 70 at 88.
[83] *See* Tarbert, *supra* note 74 at 796; REINICKE, *supra* note 78 at 115-16.

substantial discretion to classify assets among the broadly-defined risk-weighting categories of the Accord.[84] Importantly, by granting more discretion to national regulators, these concessions made the Accord more difficult to monitor and enforce. They also made it less likely to achieve its stated objective of creating a “level playing field” and preventing a “race to the bottom” in capital regulation. Other tradeoffs designed to garner political support from various constituencies also made the Accord less reflective of actual risk than is often supposed. For instance, the United States insisted on a lower risk weighting for home mortgage loans than corporate loans, a politically palatable policy that bore little relationship to actual risk measurement or financial stability. The OECD countries that negotiated the Accord also adopted very low risk weightings for loans to their own governments and banks, despite their wide variation in creditworthiness.

2. The Enforcement Stage

The Accord’s implementation deeply affected international banking in the years immediately following its adoption. Both regulators and banks devoted considerable resources to implementing the Accord. More significantly, average bank capital ratios increased around the world ahead of the Accord’s entry into force in 1992.[85] This initial effectiveness is consistent with Singer’s theory: the U.S. and U.K., having gone to great lengths to secure the Accord, naturally expected it to be diligently implemented, especially in Japan and Europe.

Over time, however, the balance of domestic interests shifted, paving the way for substantial inconsistencies in domestic implementation of the Accord. First, U.S. and U.K. pressure to maintain uniform capital levels receded. Their banks successfully recapitalized and managed to move outstanding LDC loans off their balance sheets by issuing Brady Bonds. Second, the 1990s economic slump in Japan left its banks struggling to manage an enormous amount of nonperforming loans. As a result, the international competitive threat from Japanese banks waned while domestic pressures on Japanese regulators to underenforce the Accord to avoid costly recapitalizations increased. Third, sophisticated banks around the world, pointing to the discrepancies between the Accord’s simple risk-weighting formulas and modern risk management techniques, lobbied their regulators to adopt interpretations of the Accord that would allow them to maintain lower capital levels. Finally, the absence of formal monitoring, dispute resolution or enforcement mechanisms limited the options available to the Basel Committee to ensure continued compliance with the Accord.

Thus, despite the secrecy surrounding national banking supervision, regulators used their discretion under the Accord to allow their domestic banks to recognize as capital various items whose availability to support short-term losses was doubtful.[86] At

[84] *See* HAL S. SCOTT & SHINSAKU IWAHARA, IN SEARCH OF A LEVEL PLAYING FIELD: THE IMPLEMENTATION OF THE BASLE CAPITAL ACCORD IN JAPAN AND THE UNITED STATES 46-49 (1994).
[85] *See* TONY PORTER, STATES, MARKETS AND REGIMES IN GLOBAL FINANCE 76-78 (1993); ETHAN B. KAPSTEIN, GOVERNING THE GLOBAL ECONOMY: INTERNATIONAL FINANCE AND THE STATE 120-22 (1994).
[86] For instance, at Japanese regulators’ insistence, the Accord allows regulators to include 45% of the unrealized appreciation of bank assets such as securities and real estate holdings in Tier II capital. Japan

Japan's insistence, the Accord allowed regulators to include 45% of the unrealized appreciation of certain securities and real estate holdings in Tier II capital. Japan immediately allowed its banks to do so, whereas the United States did not until 1998. The plummeting value of these assets in the 1990s was a major factor in Japan's long banking crisis and economic stagnation, and suggests that these assets were unreliable sources of regulatory capital in the first place. Such decisions appeared aimed primarily at accommodating domestic financial practices. While they may have been justifiable in some instances, they clearly jeopardized the comparability of the capital levels maintained in different countries.

National regulators also exercised substantial forbearance in applying regulatory capital requirements, in order to avoid failure or costly recapitalization of large domestic banks. Several of the largest Japanese banks would likely have been considered insolvent in the late 1990s had their regulators forced them to write off their enormous holdings of nonperforming loans, or declined to let them include deferred tax assets and certain public investments in regulatory capital.[87] Likewise, Germany allowed Deutsche Bank to issue 10-year preferred stock that was functionally the same as debt and include it in its Tier I Capital.[88] While this appears inconsistent with the letter of the Accord, in the absence of any authoritative interpretation mechanism, there was little to prevent Germany from adopting an interpretation that favored its largest international bank. Germany's decision triggered a chain reaction, as other regulators—including the U.S. Federal Reserve—allowed their banks to issue similar preferred stock to offset the competitive advantage of German banks.[89]

An additional indication that the Accord failed to achieve harmonization is its lack of effect on the allocation of regulatory jurisdiction between states. Following a successful substantive harmonization effort, one would expect states to achieve further efficiencies by curtailing concurrent jurisdiction and entrusting a single regulator with the authority to supervise each bank. For example, if capital standards were effectively harmonized and consistently applied, it would be efficient for each bank's home regulator to supervise its aggregate capital position without duplicative intervention by the states hosting the bank's foreign branches and subsidiaries. Conversely, if states are less than confident about harmonization, one would expect those which are able to do so to protect themselves by independently supervising the capital levels of foreign banks, or requiring additional assurances that supervision is adequate.

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immediately allowed its banks to do so, whereas the United States did not until 1998. The plummeting value of these assets in the 1990s was a major factor in Japan's long banking crisis and economic stagnation, and suggests that these assets were unreliable sources of "regulatory capital" in the first place.

[87] *See* SCOTT, *supra* note 68 at 321. Japanese regulators measured the regulatory capital of their banks only twice a year, thus allowing greater scope for fluctuations and possible evasion of requirements between measurements. *See* SCOTT & IWAHARA, *supra* note 84 at 55.

[88] *See* Tarbert, *supra* note 74 at 796-97.

[89] In 1996, the U.S. Federal Reserve approved the issuance of perpetual preferred shares by bank holding companies. Those instruments would be treated as debt for tax purposes (thus making the interest payments tax-deductible), but as Tier 1 capital for bank regulatory purposes. This move was followed by analogous permissive moves by other regulators and was perceived as weakening global capital standards. *See* WOOD, *supra* note 70 at 127-28.

As a matter of fact, the adoption of the Accord did not, in and of itself, catalyze a move towards a single regulator approach for capital adequacy purposes. The United States continues to apply strict capital standards to foreign bank branches, even if they are subject to consolidated, Basel-compliant requirements by their home regulator.[90] The European Union recently adopted a directive requiring financial conglomerates to be subject to consolidated supervision and capital standards considered "equivalent" by the relevant European regulator.[91] The persistence of duplicative supervision and equivalence requirements suggests that states lack confidence that an approach under which each home state would exclusively supervise its banks' worldwide activities would adequately protect their consumers. This, in turn, points to the limitations of the Accord in achieving substantive harmonization.

C. Towards Basel II

Between 1998 and 2005, the Basel Committee developed a second-generation accord on international capital standards. This effort was motivated by widespread criticism of the 1988 Accord, which fell into two broad categories. First, as discussed above, many believed that the original Accord failed to create a level competitive playing field between countries, due both to differences in national conditions and accounting rules and to the imprecision of the rules.[92] Second, and more prominently, market participants and commentators were preoccupied with several inefficiencies arising from the Accord. The rules oversimplified the capital weighing process by classifying assets within only four risk categories with fixed risk weights. This inaccuracy gave banks skewed incentives in planning their lending activity, and commentators believed that the resulting market shifts had deleterious macroeconomic effects.[93] The Accord also created incentives for banks to "arbitrate" by migrating their lending to the riskiest assets within each risk weight category in order to maximize their return on capital.[94] Other technical criticisms abounded.[95] Commentators concluded that the Accord was failing in its objective to provide a level playing field in international banking.[96]

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[90] *See* SCOTT, *supra* note 68 at __.
[91] *See* Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002, 2003 O.J. (L 35) 1.
[92] *See* SCOTT, *supra* note 68 at 320; Tarbert, *supra* note 74 at 798-99; Hal S. Scott, *The Competitive Implications of the Basle Capital Accord*, 39 ST. LOUIS U. L.J. 885, 895 (1995).
[93] For instance, some argued that the 0% risk weight assigned to OECD government securities led banks to invest massively in U.S. Treasury securities in the early 1990s instead of focusing on lending, creating a global capital crunch and prolonging the recession. *See* SCOTT, *id*. at 320; Tarbert, *supra* note 74 at 794-95.
[94] On regulatory capital arbitrage, *see* David Jones, *Emerging Problems with the Basel Capital Accord: Regulatory Capital Arbitrage and Related Issues,* 24 J. BANKING & FIN. 35 (2000). For instance, banks had an interest in lending to Mexico, one of the riskiest OECD country, before the 1994 Peso crisis. *See* SCOTT, *supra* note 68 at 317-18. The rules also favored short-term over long-term lending to non-OECD banks, a possible factor in the massive short-term bank lending whose sudden flight was instrumental in the 1997 Asian financial crisis. In essence, the criticism was that the Accord's risk weighing formula provided only a blunt approximation of the actual risk of individual assets, thus encouraging regulatory arbitrage and distorting market incentives.
[95] These included: the lack of a solid empirical foundation for choosing 8% as the required risk ratio (*see* Tarbert, *supra* note 74 at 797); the fact that the risk weighing formula ignored the role of portfolio diversification in mitigating risk (*see id*. at 799-800); and the Accord's failure to properly address

Basel II attempts to address these criticisms by establishing a substantially more complex measurement system for credit risk exposure. A full description of the new approach is beyond the scope of this Article.[97] In outline, the revised Accord allows regulators to apply an "advanced internal ratings-based" approach (A-IRB) to their largest and most sophisticated banks.[98] In essence, under A-IRB, banks determine internally certain statistical indicators in respect of each credit exposure, such as the probability that the borrower will default, the amount of the loss to the bank should the borrower default, and the effective maturity of the exposure. These indicators are then processed by a standardized formula designed to determine the amount of capital needed to cover unexpected losses within a predetermined confidence interval. A-IRB attempts to maintain a degree of standardization through the use of common definitions and formulae, and does not allow banks to freely use internal risk measures to determine the necessary amount of capital. Nevertheless, it constitutes a substantial increase in flexibility for banks to use their internal risk management techniques instead of relying on regulatory weightings. Within this framework, national regulators have a crucial supervisory role as they must certify that the internal techniques used comply with the Basel II guidelines.

Several features of the Basel II adoption process are noteworthy. First, in sharp contrast with the confidential negotiations that led to the 1998 Accord, the Committee adopted an extensive public notice and comment process to develop Basel II, and made extensive use of its web site to publicize draft rules, studies and related documents.[99] According to Barr and Miller, the Committee received more than 200 comment letters on the first consultative paper published in 1999; 259 comments on the second consultative package released in 2001; and 187 comments on its third consultative package of 2003.[100] Although it is difficult to determine whether subsequent changes to the standards originated in public comments, it is likely that they had a significant impact. In addition, the Committee initiated several rounds of quantitative impact studies to evaluate the impact of the proposed rules on financial institutions, in which more than 350 banks from 40 countries participated.[101] In parallel with these ongoing rounds of public

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derivatives and other innovative financial instruments, which are now an enormous market for banks (*see id*. at 800).

[96] *See, e.g.*, SCOTT & IWAHARA, *supra* note 84 at 69.

[97] Indeed, whereas the original Basel Accord was a thin 30-page document, the final 2005 version of the Basel II credit risk document covers 272 pages of dense prose and formulae.

[98] Less sophisticated banks are subject to either of two other approaches: standardized or internal ratings-based (IRB). The standardized approach is essentially an updated version of the Basel II risk-weight formula, made more precise by determining risk by reference to the ratings of borrowers by recognized rating agencies such as Standard & Poor's and Moody's. For example, instead of assigning a 100% weight to all loans to corporate borrowers, the Basel II standardized approach would assign only a 20% weight to a loan to a AAA-rated company such as General Electric or Berkshire Hathaway, with gradually higher weights applying to less creditworthy companies. Basel II's reliance on credit rating agencies has attracted substantial criticism, mostly on the grounds that the agencies have conflicts of interests because companies pay for ratings, and that only a relatively small number of large borrowers are rated and can thus benefit from lower weighings. The IRB approach is similar to the A-IRB approach described below, but it allows banks to determine less of the relevant statistical indicators internally than does the IRB approach.

[99] *See* Zaring, *supra* note 13 at 577.

[100] *See* Barr & Miller, *supra* note 53 at 26-27.

[101] *Id*. at 27.

comments at the Committee level, Basel II proposals were submitted to domestic administrative rulemaking procedures—often involving another layer of public notice and comment—in the United States, Europe and elsewhere.[102] As will be discussed below, global administrative law scholars argue that this expanded process increased the transparency and legitimacy of the rules adopted by the Committee. However, in contrast with the swift adoption and implementation of the 1988 Accord, the Basel II process has formally been ongoing since 1999, and its full domestic implementation in major banking markets, when completed, will have taken nearly a decade.

Second, despite the fact that the process was steered by expert regulators acting within a well-established network, distributive concerns, domestic pressures and other political considerations played a central role. The initial consultative package was stalled for months due to disputes between the U.S. and Germany.[103] Following its release, a major lobbying effort by banks and financial industry groups further delayed the process and resulted in significant modifications to the initial approach.[104] The second consultative package attracted a flood of comments and criticism from market participants and the media, some suggesting that global capital standards should be abandoned.[105] German concerns about the effect of Basel II on small and medium enterprises escalated, to the point where Chancellor Schroeder himself announced in 2001 that he would not support EU implementation of the proposal.[106] His challenge was met with substantial concessions by the Basel Committee.[107] International banks also obtained significant modifications to the initial proposal.[108] Finally, under the pressure of smaller banks, U.S. regulators announced in 2003 that, contrary to previous expectations, they would only apply Basel II to a small number of internationally active banks.[109] Their move was regarded as brinksmanship, but was instrumental in securing favorable changes to the proposals in 2004.[110]

Finally, many aspects of Basel II may aggravate the flaws that led to Basel I's inconsistent application and failure to level the competitive playing field. The revised Accord preserves the loose definition of capital from Basel I, leaving open the possibility that regulators might continue to give inconsistent interpretations. Basel II also expands the discretionary role of national supervisors, particularly in respect of large international

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[102] *Id*. at 29-31 (United States), 35-39 (Europe), 39-41 (China and India).
[103] The disputes concerned the use of agency ratings (which favored the United States) and the legitimacy of German regulatory rulings assigning low risk weights to commercial mortgages (which favored German banks). The consultative paper retained the use of agency ratings and contained compromise language regarding commercial loans, which suggested that the German practice might be approved. See WOOD, *supra* note 70 at 130-33.
[104] *See id.* at 134-35.
[105] *See id.* at 140-41.
[106] *See* Klaus C. Engelen, *Basel II Under Siege*, THE INT'L ECON. 18 (Winter 2002).
[107] In July 2002, the Committee announced that it would allow banks to allocate a lower capital charge to SMEs. In Duncan Wood's words, "political wrangling had indeed been successful in gaining a key dispensation for the German economy." WOOD, *supra* note 70 at 143.
[108] *See id.* at 143-44.
[109] *See id.* at 145; Christopher Whalen, *Gunfight at the Basel II Corral*, THE INT'L ECON. 72 (Winter 2004); Denis Bouton & Daniel Amadieu, *Les possibles conséquences d'une application différenciée de la réforme Bâle II aux Etats-Unis et en Europe*, 87 REVUE D'ÉCONOMIE FINANCIÈRE 121 (2007).
[110] *See id.* at 146.

banks adopting the A-IRB approach. This expansion will multiply the opportunities for national regulators to exercise forbearance in response to domestic political pressures. In addition, the technical capacity of even sophisticated regulators to effectively supervise the internal risk functions of large banks has been questioned. In sum, while Basel II does not enhance international monitoring and enforcement capabilities, its flexible rules will make defections harder to detect, thus making what reputational sanctions exist less effective. If this assessment is correct, Basel II may result from the same domestic political shifts that underlie the movement towards laxer implementation of Basel I.

D. Conclusions

The history of the Basel Accord is consistent with the limitations of TRNs discussed in Part II. The debates surrounding the adoption of the Accord reveal that, even faced with a collective action problem that requires cooperation to reduce systemic risk and improve global financial stability, national regulators take positions that reflect the interests of domestic constituencies. As a result, the adoption of common standards will require solving distributive problems when the interests of these constituencies diverge. In this case, the Accord was brought into existence by coercive pressure on the part of U.S. and U.K. regulators motivated by domestic considerations. Moreover, because bank regulators have no authority to offer side payments or linkages to other issues, tradeoffs needed to overcome distributive problems had to be incorporated within the substantive provisions of the accord itself, undermining its effectiveness.

At the compliance stage, the Accord appears to have been remarkably effective in the years immediately following its adoption, as substantial resources were devoted to compliance and bank capital levels increased around the world. However, in later years, decline of domestic interest in bank capital adequacy rules in the U.S. and U.K., pressures to renege in Japan due to an ongoing financial crisis, lobbying by banks around the world for a more lenient regime, and lack of strong monitoring and dispute resolution mechanisms combined to undermine the effectiveness of the Accord. The lack of monitoring, dispute resolution or enforcement mechanism—beyond reputational considerations—made it difficult for the Committee to limit the ability of national regulators to respond to these domestic pressures. The Basel II negotiations proved more intensely political, and the final framework, while more reflective of modern risk management practices, is also a product of the domestic pressures for more flexibility in regulatory capital standards. The limitations of the Basel Accord offer sobering perspective on the claim that networks "offer an alternative to the paradigm of a regulatory race to the top or bottom."[111]

IV. THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

IOSCO was established in its present form in 1986 and is one of the most institutionalized TRNs, with a permanent secretariat headquartered in Madrid and

[111] Anne-Marie Slaughter & David Zaring, *Networking Goes International: An Update*, 2 ANNU. REV. LAW SOC. SCI. 211, 217 (2006).

membership including regulators from more than 170 jurisdictions. Most of IOSCO's specialized work takes place within a Technical Committee composed of regulators from the most developed securities markets. This section will first examine IOSCO's most visible achievement, namely the worldwide coordination of international securities law enforcement through an extensive network of Memoranda of Understanding (MOUs). It will then turn to other significant IOSCO initiatives, including the failed effort to establish uniform capital adequacy rules for securities firm, the successful adoption of a standardized form for non-financial disclosure by public companies, and efforts to draft substantive best practices of securities regulation. It will show that, while IOSCO has been largely successful at solving the coordination problems posed by securities fraud enforcement among developed countries, the more fundamental conflict between developed economies and offshore financial centers went unaddressed until September 11, 2001, when the former turned to a more coercive approach. Likewise, despite the potential benefits of uniform capital rules for securities firms, IOSCO's efforts were defeated by conflicting interests among its members' domestic constituencies.

A. Coordinating Securities Law Enforcement

In the past two decades, several trends in global finance have raised the profile of securities law enforcement as an international regulatory issue. Because the securities of major corporations are now traded simultaneously in several countries, the effects of accounting fraud and other corporate wrongdoing are felt by investors everywhere. In addition, the rise of efficient, low-cost telecommunications and the development of the Internet have accelerated financial market integration, but also created new opportunities for fraud and market manipulation as fraudsters can easily conduct their activities far from the jurisdiction of their victims, in an attempt to evade regulatory action.

National securities regulators have responded to these trends by developing an elaborate informal system to coordinate their enforcement activities. Starting in the mid-1980s, IOSCO adopted a series of resolutions aimed at promoting mutual assistance among its members in protecting their markets against fraud. The 1986 Rio Declaration called upon national regulators to "provide assistance on a reciprocal basis for obtaining information related to market oversight and protection of each nation's markets against fraudulent securities transactions."[112] In the following decades, IOSCO developed an increasingly elaborate set of recommendations to address myriad technical obstacles to effective assistance. When national laws requiring "double illegality" as a prerequisite for assistance hindered enforcement efforts, and when national confidentiality requirements and limited investigative powers limited information-sharing, IOSCO encouraged national regulators to request domestic legislative changes.[113]

Over time, IOSCO encouraged the development of a network of bilateral "memoranda of understanding" (MOUs) between national regulators, which could better

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[112] IOSCO, A RESOLUTION CONCERNING MUTUAL ASSISTANCE (1986).
[113] *See, e.g.*, IOSCO, A RESOLUTION ON COOPERATION (1989); *see also* IOSCO, PRINCIPLES FOR MEMORANDA OF UNDERSTANDING §1 (1991), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD17.pdf; IOSCO, A RESOLUTION ON ENFORCEMENT POWERS (1997).

take into account specific national laws and policies. It published general principles to ensure that MOUs reflected basic standards of cooperation.[114] Over the 1990s, hundreds of bilateral and regional MOUs were concluded between IOSCO members.[115] In 2002, the organization adopted a Multilateral Memorandum of Understanding (MMOU) to provide for "the fullest mutual assistance possible" based on uniform principles.[116] Although legally non-binding, the IOSCO MMOU is now the principal international instrument for securities enforcement cooperation, having been signed by 41 national regulators.[117]

As a general rule, the MMOU provides that signatories will, within its framework, "provide each other with the fullest assistance permissible to secure compliance with [their respective securities laws and regulations.]"[118] It includes precise rules concerning the scope of assistance required, the procedures to be followed, permissible uses of the information provided, confidentiality requirements, and limited circumstances under which assistance may be denied. IOSCO members may only sign the MMOU after undergoing a review process confirming that they have the legal authority to comply with all of its provisions.[119] IOSCO also maintains an expert panel to monitor each member's continued "willingness and ability" to comply with the MMOU, and has the authority to expel members who persistently fail to do so.[120] While comprehensive statistics have not been compiled, surveys by IOSCO indicate that a substantial number of assistance requests are made between national regulators.[121] The SEC points to several high-profile examples of successful enforcement cooperation within the IOSCO framework, including Ahold, Royal Dutch/Shell, Parmalat and Vivendi Universal.[122]

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[114] *See* IOSCO, PRINCIPLES FOR MEMORANDA OF UNDERSTANDING, *Id*. The principles have been used as the starting point for many bilateral MOU negotiations.

[115] *See* IOSCO, LIST OF BILATERAL MOUS SIGNED BY IOSCO MEMBERS, *at* http://www.iosco.org/library/index.cfm? section=mou (accessed June 9, 2007).

[116] *See* IOSCO, MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULATION AND COOPERATION AND THE EXCHANGE OF INFORMATION, *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf.

[117] *See* IOSCO, LIST OF SIGNATORIES TO THE IOSCO MULTILATERAL MEMORANDUM OF UNDERSTANDING CONCERNING CONSULTATION AND COOPERATION AND THE EXCHANGE OF INFORMATION, *at* http://www.iosco.org/library/index.cfm? section=mou_siglist (accessed June 9, 2007).

[118] See IOSCO, MULTILATERAL MEMORANDUM OF UNDERSTANDING, *supra* note 116, § 7(a).

[119] *See id.*, App. B.

[120] *See id*., Art. 16(b).

[121] The U.S. SEC reports that in its fiscal year 2003, it made approximately 309 requests for assistance to foreign regulators, and responded to 344 requests. *See* SEC, International Cooperation in Securities Law Enforcement (Fall 2004). In an April 2007 survey, out of 32 developing country IOSCO members, 4 reported receiving more than 50 requests a year; 4 reported between 16 and 50 requests; and 10 reported between 1 and 5 requests. Only three regulators reported no requests. *See* IOSCO, OBSTACLES TO JOINING THE IOSCO MOU (2007), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD246.pdf.

[122] *See* SEC, INTERNATIONAL COOPERATION IN SECURITIES LAW ENFORCEMENT (2004), *available at* www.sec.gov/about/offices/oia/oia_enforce/intercoop.pdf; *see also* Felice B. Friedman, Elizabeth Jacobs & Stanley C. Macel IV, *Taking Stock of Information Sharing in Securities Enforcement Matters*, 10 J. FIN. CRIME 37 (2002). In these four high-profile cases, the SEC cooperated with the home regulators of U.S. listed foreign companies in investigating fraudulent accounting and disclosure practices. In *Ahold*, the SEC cooperated with Dutch authorities in an investigation of accounting fraud at a U.S. subsidiary of Ahold, a Dutch company. Notably, at the request of Dutch authorities conducting a parallel investigation in the

Based on the information available, IOSCO appears to have been largely successful in developing securities enforcement cooperation among developed countries. This success, while remarkable, has significant limits. First, while regulators agree in the MMOU to assist one another in enforcing their respective laws to cross-border conduct, the system does not involve substantive harmonization of securities laws. For instance, different states retain very different substantive laws governing securities fraud and disagree on such fundamental matters as the prosecutor's burden of proof, the appropriateness of criminal penalties, and the definition of offenses such as market manipulation and insider trading. In salient cases, these discrepancies sometimes lead to acrimonious judicial disputes regarding which jurisdiction's laws should apply to a cross-border transaction.[123] The vast differences that persist in substantive securities laws are illustrated by the fact that, while regulators may assist their foreign counterparts in investigating and prosecuting fraudulent activity, the resulting foreign judgments will generally not be entitled to recognition or enforcement.[124]

Second, the success of IOSCO in achieving this important—albeit limited—degree of international cooperation is accounted for by the fact that, at least among states with developed financial markets, mutual assistance in securities law investigations does not raise substantial distributive or enforcement issues. The rules governing mutual assistance are facially neutral and, over an extended period of time and many cases, it is unlikely that one state will accrue disproportionate benefits from such provisions. As far as enforcement is concerned, developed states lack incentives to renege on mutual assistance agreements.

On the one hand, lowering domestic regulatory standards to attract fraudsters would not attract any net benefits, because it would undermine confidence in national financial markets, with negative repercussions on capital allocation and growth for the entire domestic economy. While these social costs of uncontrolled fraud would be significant, its benefits would be marginal in terms of employment, tax or infrastructure development. Thus, there is little prospect of an international "race to the bottom" in securities fraud regulation. On the other hand, states could be said to lack incentives to

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Netherlands, the SEC did not seek penalties in its enforcement action "because of potential double jeopardy issues under Dutch law" and of "the need for continued cooperation between the SEC and regulatory authorities in other countries." *See* SEC Litigation Release No. 18929 (Oct. 13, 2004). In *Royal Dutch/Shell*, the SEC cooperated extensively with U.K. and Dutch authorities in investigating massive overstatements of proven hydrocarbon reserves by major British and Dutch oil and gas companies. *See* SEC, *id.* at 5. Likewise, in *Parmalat*, the SEC cooperated with Italy's securities regulator in investigating large-scale accounting fraud at a U.S. listed Italian dairy company. *See* SEC Litigation Release No. 18527 (Dec. 30, 2003); SEC Litigation Release No. 18803 (Jul. 28, 2004). In *Vivendi Universal*, French authorities provided assistance to the SEC in investigating false disclosures regarding a French company's liquidity. *See* SEC Litigation Release No. 18523 (Dec. 24, 2003).

[123] *See, e.g.,* Roby v. The Corporation of Lloyd's, 824 F.Supp. 336 (S.D.N.Y. 1992), aff'd 996 F.2d 1353 (2d Cir.), cert. denied, 510 U.S. 945, 114 S.Ct. 385 (1993). In that case, U.S. investors in Lloyd's insurance syndicates sued Lloyd's for several alleged violations of U.S. securities laws, urging U.S. courts to disregard a U.K. choice of law clause in the agreement. The Second Circuit, while denying to override the clause, acknowledged that "the United States securities laws would provide the [plaintiffs] with a greater variety of defendants and a greater chance of success due to lighter scienter and causation requirements." *Id.* at 1366.

[124] *See* William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT'L L.J. 161, 187-89 (2002).

enforce their laws vigorously against fraudsters who target victims abroad, because of the lack of negative effect on their national welfare. There is little evidence, however, that this type of bias significantly affects the patterns of securities enforcement cooperation among developed states. By way of example, when U.S. courts developed the doctrines governing their jurisdiction in transnational securities fraud cases, they put a premium on protecting U.S. investors.[125] Nevertheless, they also expressed concern to avoid that the United States "be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[126] Expressed more formally, each country is legitimately concerned that, if its financial markets are used as a base to defraud foreigners, international confidence will be undermined and the role of its markets in channeling international capital to domestic productive uses will be weakened. Doubtlessly, cooperation is also assisted by the fact that virtually all legal systems and cultures view fraud as reprehensible. While some would argue that, for instance, low taxes on financial transactions can be part of a legitimate policy aimed at attracting financial activity from abroad, it is hard to imagine that a parallel argument about fraud laws would be taken seriously.

For all these reasons, while there may in theory be incentives for discriminating against foreigners, in practical terms international securities law enforcement is

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[125] U.S. courts have long recognized the extraterritorial reach of securities fraud laws. In general, transnational securities fraud falls within the jurisdiction of U.S. courts if it includes either conduct or effects within the United States. The conduct test is applied broadly. It requires that "(1) the defendant's activities in the United States were more than 'merely preparatory' to a securities fraud conducted elsewhere … and (2) these activities or culpable failures to act within the United States 'directly caused' the claimed losses." Itoba Ltd. v. LEP Group PLC, 54 F.3d 118, 122 (2d Cir. 1995), *cert. denied*, 516 U.S. 1044 (1996); *see also* Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045-46 (2d Cir.1983); Zoelsch v. Arthur Andersen & Co., 824 F.2d 27, 29-30 (D.C.Cir.1987). Other circuits apply the second branch more broadly, requiring only that "at least some activity designed to further a fraudulent scheme occurs within this country." SEC v. Kasser, 548 F.2d 109, 114 (3d Cir.1977). *See also* Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir.1979); Grunenthal GmbH v. Hotz, 712 F.2d 421, 424-25 (9th Cir.1983).

In practice, when U.S. investors have been harmed by fraudulent activities, courts often rely on relatively minor activities in the United States to assert jurisdiction. Even under the stricter test applied by the Second, Fifth and D.C. Circuits, jurisdiction is often asserted even when the activities outside the United States substantially outweigh those within it, especially where U.S. investors are affected. *See, e.g.*, Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (1972) ("we see no reason why, for purposes of jurisdiction to impose a rule, making telephone calls and sending mail to the United States should not be deemed to constitute conduct within it"); Robinson v. TCI/US West Communications Inc., 117 F.3d 900 (5th Cir. 1997) (holding that sending of a letter from the United States instructing auditors in the United Kingdom to prepare a second valuation of certain shares is sufficient to establish jurisdiction on the part of an investor alleging to have been deceived by a promise that there would only be one valuation).

Therefore, the conduct test effectively asserts U.S. jurisdiction over fraudulent securities transactions affecting persons in the United States. In addition, even in cases where conduct in the United States is not established, jurisdiction may be asserted under the "effects test" where "conduct outside the United States has had a substantial adverse effect on American investors or securities markets." Robinson, 117 F.3d 900, 905. *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). Due to the broad application of the conduct test, the effects test announced in *Schoenbaum* is rarely invoked in practice.

[126] IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir.1975). *See also* United States v. Cook, 573 F.2d 281 (5th Cir.1978) (rejecting a jurisdictional challenge to a conviction relating to a Ponzi scheme that victimized foreign investors but involved U.S. securities and considerable U.S. conduct.)

essentially a pure coordination problem. The main obstacle to effectively repressing transnational fraud is not "cheating" by individual states, but the numerous differences in national laws, policies and resources that may allow fraudsters to escape enforcement. This is why international efforts have focused on reducing these obstacles, consisting mostly in inconsistencies in national laws and lack of appropriate powers by national regulators. They have also consisted of putting in place uniform rules and procedures so that assistance requests can be processed promptly and efficiently within a shared framework. It is also why these efforts have been largely successful, despite the non-binding nature of the instruments and the lack of robust enforcement mechanisms. Once achieved, coordination is largely self-sustaining, which is why compliance with the IOSCO standards does not require dispute-resolution or enforcement mechanisms. Likewise, since enforcement coordination does not have systematic distributive implications between states, regulators have largely been successful in overcoming domestic constraints that hindered compliance with IOSCO standards.

B. Reining In Offshore Financial Centers

The considerations outlined above indicate that harmful regulatory competition and discrimination are unlikely to be a major obstacle to antifraud cooperation among developed countries with substantial financial markets. The calculus, however, leads to a quite different result for countries whose financial markets are underdeveloped or nonexistent, with a relatively minor role in domestic capital allocation and economic activity. For such countries, attracting financial activity through measures such as low taxes and lenient regulations that turn a blind eye to dubious practices and limit or prohibit cooperation with onshore regulators, may be attractive. Although such tax and regulatory heavens have long existed, the globalization of capital and technological advances led to a vast expansion of offshore financial activity in the 1990s. This expansion, in turn, caused increasing concern in developed countries that offshore financial centers (OFCs) may serve as havens for tax evasion, international securities fraud, money laundering, terrorist financing and other illicit activities.

The terrorist attacks of September 11, 2001 lent a greatly increased sense of urgency to the existing international efforts to address the problems associated with OFCs. Prior to that time, efforts at securing voluntary cooperation by the OFCs had met with limited success. This is unsurprising, given that the attractiveness of the OFCs arose in large part from their lax regulatory systems and the secrecy they offered; they thus had an incentive to resist international standards and to "cheat" in their implementation, otherwise their comparative advantage would, at least to some degree, revert to onshore jurisdictions. Their incentives were fundamentally at odds with those of the developed states and, in the wake of September 11, the latter turned to a coercive approach to secure enhanced regulatory cooperation on the part of OFCs. While these efforts focused primarily on terrorist financing and money laundering, they had an impact on regulatory cooperation in securities fraud as well.

In 1999, the Financial Action Task Force (FATF), an international body created at the G-7's initiative to combat international money laundering and terrorist financing, had launched a process aimed at identifying jurisdictions that failed to cooperate with international anti-money laundering efforts.[127] The FATF's membership is composed of developed countries and large emerging economies that are "strategically important," notably in terms of their GDP, banking sector and commitment to AML/CFT efforts.[128] Among the criteria to be used to determine whether countries have adequate regulation and supervision of financial institutions, the FATF included compliance with IOSCO standards on securities regulation.[129] The FATF criteria also expressly enjoined countries to remove laws prohibiting exchange of information and provision of enforcement assistance to foreign authorities.[130] The FATF encouraged its members to consider adopting countermeasures against noncooperative states that failed to improve their records. Examples of such countermeasures included: bolstering customer identification requirements; requiring financial institutions to report transactions linked with noncooperative countries; and eventually restricting or prohibiting transactions with these countries.[131]

On a national level, the 2001 adoption of the PATRIOT Act by the United States lent teeth to the FATF list, by including such international evaluations among the factors to be used by U.S. authorities in identifying noncooperative jurisdictions and imposing costly additional requirements on U.S. financial institutions doing business with entities therein.[132] Also, in the most visible case of concerted action, the FATF publicly threatened Nauru with sanctions in 2001 following reports that the country was used extensively for money laundering by Russian organized crime.[133] This followed similar threats against the Philippines and Ukraine.[134] Following these actions, the FATF gradually reported substantial improvements in individual countries' practices.[135] As of October 13, 2006, no countries were left on the FATF list.[136] Nevertheless, doubts persist regarding the effectiveness of this process, as FATF determinations of compliance are largely based on self-reporting by OFCs.[137]

The apparent progress in the fight against money laundering reflects the high political priority accorded to the topic by major powers, particularly the United States. In particular, the coercive approach adopted by the FATF to enforce cooperation was stronger than that of the FSF, another network of regulators set up to address global financial stability issues. In 2000, the FSF embarked upon an initiative to evaluate the

[127] *See* Jared Wessel, *The Financial Action Task Force: A Study in Balancing Sovereignty with Equality in Global Administrative Law*, 13 WIDENER L. REV. 169 (2006).
[128] *See* FATF Membership Policy (Feb. 29, 2008), http://www.fatf-gafi.org/dataoecd/25/48/41112798.pdf.
[129] FATF, Report on Non-Cooperative Countries and Territories (2000) at 2, fn. 4.
[130] Id. at 5.
[131] *Id.* at 8.
[132] *See* USA PATRIOT Act, Pub. L. No. 107-56, §§ 311, 312, 115 Stat. 272, 298-306 (2001).
[133] *See Tiny Pacific Island Is Facing Money-Laundering Sanctions*, N.Y. TIMES (Dec. 6, 2001).
[134] *See The Philippines Moves Against Bank Secrecy*, N.Y. TIMES (Oct. 13, 2001).
[135] FATF's annual NCCT reports describing the progress made by jurisdictions previously listed as uncooperative, proposed sanctions, and de-listings are available at www.fatf-gafi.org.
[136] *See* FATF, Non-Cooperative Countries and Territories, *at* http://www.fatf-gafi.org/document/4/0,3343,en_32250379_32236992_33916420_1_1_1_1,00.html (accessed on Feb. 18, 2008).
[137] There are anecdotal reports that certain G7 countries with significant political and economic links to specific OFCs resisted the implementation of stricter rules and verifications procedures by the FATF.

level of compliance of OFCs with major international financial standards, including IOSCO's. In a June 2000 press release, the FSF classified 25 states in "Group III," which included jurisdictions whose legal infrastructure, supervisory practices, regulatory resources and/or level of cooperation were "largely of a lower quality" than those of other OFCs. While the FSF, unlike the FATF, did not recommend coercive measures, the initial list of "noncooperative states" issued by FATF in June 2000 included 11 countries previously identified in the May 2000 FSF press release.[138] In addition, the FSF launched a large cooperative effort with the IMF to systematically review the OFCs' performance in complying with the relevant standards.[139] In 2005, the FSF, while acknowledging that further work was necessary to improve compliance, stated that the initial list had "served its purpose" and was "no longer operative."[140] Here again, the combination of "naming and shaming" by the FSF, IMF review of compliance, and more coercive measures by the FATF pushed a number of important offshore jurisdictions to cooperate, although others have not yet volunteered for IMF assessment.[141]

C. Other IOSCO Initiatives

In addition to enforcement cooperation, IOSCO has been active in several areas of international securities regulation. While a full account of IOSCO's activities is beyond the scope of this article, three of its other high-profile initiatives deserve mention. First, as pointed out by David Singer, an important but little-discussed "negative case" of international regulatory cooperation is IOSCO's failed effort to adopt uniform capital adequacy rules for securities firms.[142] This effort, which occurred in parallel with the Basel Committee's development of its Accord on bank capital adequacy and was strongly supported by U.K. authorities, met with substantial resistance from U.S. and Japanese regulators and was abandoned in 1993.

Singer's account of this case points to the domestic considerations that motivated each regulator. After the 1987 market crash threatened the stability of British financial institutions, Britain's SIB needed to address contradictory pressures: the demand for stricter capital regulation, on the one hand, versus the declining international competitiveness of British securities firms, on the other. It reacted by seeking an international accord on capital adequacy through IOSCO. U.S. banks, fearful that such an accord might lead to the adoption of consolidated supervision and impair their unrivaled international competitiveness in derivatives and other innovative financial instruments, pressured their regulators to resist U.K. plans. Japanese regulators were also skeptical and, eventually, the draft accord failed to gather sufficient support. Thus,

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[138] *See* FATF, Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures (2000), *available at* http://www.fatf-gafi.org/dataoecd/56/43/33921824.pdf; FSF Press Release (May 25, 2000). These 11 countries were the Bahamas, the Cayman Islands, Cook Islands, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, St. Kitts and Nevis, and St. Vincent and the Grenadines.

[139] *See* IMF Press Release (July 26, 2000). Many of the IMF's staff assessments of OFCs are available at http://www.imf.org/external/np/ofca/ofca.asp.

[140] FSF Press Release (March 11, 2005).

[141] *See* IMF, *Offshore Financial Centers: The Assessment Program—A Progress Report* (Feb. 2006).

[142] Singer, *supra* note 54 at 553.

despite a plausible case that uniform capital standards for securities firms would have reduced global systemic risk, domestic political considerations overrode the collective interest.

In 1998, IOSCO adopted a standardized form intended to be used by its members as a uniform standard for non-financial disclosure by foreign firms raising capital in their jurisdiction. The form was in fact virtually identical to the SEC's existing form for foreign private issuers, and its adoption reflected little more than exercise of U.S. market power in setting global disclosure standards. IOSCO has also adopted many other consultative papers, voluntary standards and best practices, most notably its Objectives and Principles of Securities Regulation, a high-level compendium meant to assist national authorities in establishing and maintaining high regulatory standards. While these standards have undoubtedly assisted domestic efforts to improve financial market regulation and are used by the IMF and World Bank to evaluate progress in these areas, they also tend to be pitched at a general level and to avoid precise normative pronouncements on potentially controversial issues.[143]

D. Conclusions

IOSCO's achievements and failures are representative of the limits on the effectiveness of TRNs outlined in Part II. Thus, IOSCO has been successful in coordinating mutual assistance between developed market regulators in securities law enforcement, an area in which distributive and enforcement problems are largely absent. The clash of interests between major financial markets and OFCs, however, undermined cooperation on securities law enforcement until 9/11 escalated concerns about money laundering and terrorist financing, and the FATF and U.S. authorities resorted to coercive measures. Even under this new regime, OFCs retain incentives to renege and it is doubtful that sustained compliance can be achieved through TRNs. Likewise, divergent domestic pressures influenced the position of national regulators in negotiating an agreement on capital adequacy for securities firms, eventually leading to the proposed rules' demise. Other efforts by IOSCO have been characterized by the dominance of certain regulators or by avoidance of controversial substantive standards.

V. THE INTERNATIONAL COMPETITION NETWORK

From the end of World War II until the 1980s, antitrust was a frequent source of regulatory conflict between Western market economies. More recently, important initiatives to coordinate investigations and merger reviews have emerged, buttressed both by formal agreements and non-binding recommendations in the OECD and UNCTAD, but generally stopping short of robust legal commitments or substantive harmonization of antitrust laws. It is against this background that a new TRN, the International Competition Network, was launched in 2001. Thus, before turning to an examination of the ICN's structure and achievements, it is useful to examine the complex patterns of

[143] *See, e.g.*, Harry McVea, *Hedge Fund Asset Valuations and the Work of the International Organization of Securities Commissions (IOSCO)*, 57 INT'L & COMP. L.Q. 1 (2008).

international regulatory cooperation and conflict that emerged prior to its establishment. Then, a review of the ICN's ongoing work will reveal that it is just overcoming its initial reluctance to address controversial substantive issues of competition law. Whether its more ambitious recent efforts will be successful remains to be seen.

A. International Antitrust Cooperation

Prior to World War II, fundamental differences of economic policy between the United States and Europe made even the most elementary international antitrust cooperation efforts problematic. While modern U.S. antitrust law appeared in the late 19th and early 20th centuries, when the Sherman and Clayton Acts[144] were adopted and vigorously enforced to counter powerful monopolies, European countries tolerated and sometimes encouraged cartels well into the 1930s.[145] This policy divergence gradually abated after the war, but several ambitious efforts at substantive harmonization failed while the United States aggressively prosecuted international cartels by applying its laws extraterritorially. As the European Union grew in size and influence, it also began applying its laws extraterritorially and developed an alternative model of competition policy that, for many developing and post-Communist states, has proven more attractive than U.S. antitrust. Despite this rivalry, the U.S. and E.U. pursued international cooperation to facilitate investigations and merger reviews, principally through OECD recommendations and the adoption of bilateral antitrust cooperation treaties. In the late 1990s, however, this approach appeared to have reached a plateau.

1. Failure of Harmonization, Unilateralism and Conflict

As part of the U.S.-led postwar effort to restructure the international economic system, Western states attempted to incorporate basic antitrust provisions in the International Trade Organization structure contemplated by the 1948 Havana Charter. After the Charter's failure, the United States turned to a unilateral and extraterritorial approach to antitrust in order to protect its markets against the effects of foreign anticompetitive practices. This pattern was famously consecrated by the *Alcoa* case, in which Learned Hand J. held that such practices "were unlawful, though made abroad, if they were intended to affect imports and did affect them," a doctrine that came to be known internationally as the "effects principle."[146] From the 1950s to the 1970s, relying on the effects principle, U.S. authorities aggressively prosecuted several international cartels that affected U.S. markets.

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[144] Respectively, 15 U.S.C. §§ 1-7 and 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53.

[145] *See* Marie-Laure Djelic and Thibaut Kleiner, *The international competition network: Moving towards transnational governance* in TRANSNATIONAL GOVERNANCE: INSTITUTIONAL DYNAMICS OF REGULATION 287, 288-89 (Marie-Laure Djelic and Kerstin Sahlin-Andersson eds. 2006). As a result, efforts by the League of Nations to create a legal framework for international competition did not produce substantial progress. *See* Spencer Weber Waller, *The Internationalization of Antitrust Enforcement*, 77 B.U. L. REV. 343, 349-50 (1997).

[146] United States v. Aluminum Co. of America, 148 F.2d 416, 444 (2d Cir. 1945). Learned Hand J. also stated the effects principle in more general terms by stating that "any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends." *Id*. at 443.

During much of that period, European countries lacked the inclination or the capacity to reciprocate by imposing stricter competition rules on U.S. businesses. Their own competition laws were less stringent than the Sherman Act, and they were dependent on the United States to protect their security and support their economic recovery. Nevertheless, because extraterritorial antitrust prosecutions by U.S. authorities clashed directly with the interests of their domestic producers, several countries opposed extraterritorial U.S. antitrust laws through legal and diplomatic means. They appealed to customary international law to circumscribe U.S. jurisdiction, taking the position that the effects principle an illegitimate basis of jurisdiction. There protests were never adjudicated and the legality of extraterritorial antitrust prosecutions based on the so-called "effects principle" remained controversial. The United Kingdom, Canada and other countries also adopted blocking statutes aimed at hindering extraterritorial enforcement of U.S. antitrust laws.[147] While these tactics did not completely dissuade U.S. extraterritorial enforcement, the risks of diplomatic confrontation and conflicting judicial decisions induced prosecutors and courts to incorporate considerations of international comity in their extraterritorial application of U.S. antitrust laws.[148]

In parallel with these developments, Europe's position and role in international antitrust underwent fundamental changes. American authorities in occupied Germany imposed a decartelization law that eventually developed into an extensive competition regime.[149] Following the adoption of the Treaty of Rome and the creation of the European Economic Community, European states gradually centralized competition policy and enforcement in the hands of supranational institutions, and the common competition law became stronger than their preexisting national laws.[150] The decline of

[147] Blocking statutes evolved over time; the later ones typically included provisions allowing authorities to prohibit private persons from complying with discovery requests relating to U.S. antitrust suits, denying recognition and enforcement of foreign antitrust judgments, and allowing parties to recover treble damages awarded in foreign antitrust suits ("clawback statutes"). *See, e.g.*, Protection of Trading Interests Act, 1980, ch. 11 (U.K.); Foreign Proceedings (Excess of Jurisdiction) Act 1984, No. 3 (Aust.); Foreign Extraterritorial Measures Act, 1984, ch. 49 (Canada). *See also* Loi n° 80-538 du 16 juillet 1980 relative à la communication de documents et renseignements à des autorités étrangères dans le domaine du commerce maritime et des transports par air (France). Following the Watchmakers of Switzerland case, the Swiss government adopted regulations mandating some of the actions required by the agreement between competitors, and the judgment was subsequently modified to avoid compelling the Swiss defendants to breach local law. *See* MARK R. JOELSON, AN INTERNATIONAL ANTITRUST PRIMER 68-69 (3d ed. 2006).

[148] Over the 1970s and 1980s, U.S. courts developed doctrines based on comity, reciprocity, reasonableness and similar factors to restrain the reach of the antitrust statutes. *See, e.g.*, Timberlane Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976); Mannington Mills v. Congoleum Corp., 595 F.2d 1287 (3rd Cir. 1979); Montreal Trading Ltd. v. Amax Inc., 661 F.2d 864 (10th Cir. 1981), *cert. denied*, 455 U.S. 1001 (1982). The Third Restatement of Foreign Relations Law similarly adopted a balancing approach. *See* THIRD RESTATEMENT § 402, 403. This view, however, was not universally held even during that period. *See, e.g.,* National Bank of Canada v. Interbank Card Association, 666 F.2d 6 (2d Cir. 1981); Laker Airways Ltd. v. Sabena, 731 F.2d 909 (D.C. Cir. 1984). Notably, the Supreme Court later rejected balancing doctrines in favor of a return to effects-based jurisdiction. Hartford Fire Ins. Co. v. California, 509 U.S. 764 (1993); *see generally* Andreas F. Lowenfeld, *Conflict, Balancing of Interests, and the Exercise of Jurisdiction to Prescribe: Reflections on the Insurance Antitrust Case*, 89 AM. J. INT'L L. 42 (1995). On current U.S. law on the matter, *see generally* Eleanor M. Fox, *Competition Law*, *in* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 345-353 (2002).

[149] *See* Djelic and Kleiner, *supra* note 145 at 290.

[150] *See* Andrew Guzman, *The Case for International Antitrust*, 22 BERK. J. INT'L L. 355, 361 (2004).

state-centered economic policy and the corresponding trends towards economic liberalization and privatization also pushed competition policy closer to the consumer-oriented standards favored in the United States.[151] Despite this trend towards convergence, renewed attempts to harmonize substantive aspects of international competition policy through the OECD and UNCTAD proved essentially fruitless.[152] As will be seen below, this convergence also made more visible the remaining areas of disagreement between the two blocs, both on substantive antitrust analysis and on enforcement methods.

Meanwhile, the increasing clout of Europe in world affairs also increased its capacity to enforce its competition laws extraterritorially. Europe's integrated economy eventually rivaled that of the United States, and a large proportion of multinational firms operated or maintained assets within European territory, making them vulnerable to enforcement by EU authorities. Europe now has both a greater interest in combating foreign anticompetitive practices that affected its markets, and substantial capacity to compel foreign firms to comply with its laws. A first consequence of this realignment of interest and capabilities was the rise of extraterritorial enforcement of European competition law. European institutions gradually abandoned their insistence on the illegality of the effects principle. Indeed, they effectively applied it to reach anticompetitive practices by foreign firms in a series of cases culminating with *Wood Pulp II*.[153] Likewise, in *Gencor*, a case involving a transaction by which British and South African companies would combine their platinum operations in South Africa and which had been approved by South African authorities, the European Court of First Instance concluded that the assertion of E.U. merger review jurisdiction over transactions between foreign firms was "justified under public international law when it is foreseeable that a proposed concentration will have an immediate and substantial effect in the Community."[154] Traditional European objections to extraterritorial antitrust jurisdiction

[151] *See* Djelic and Kleiner, *supra* note 145 at 291-93.
[152] *See* Weber Waller, *supra* note 145 at 350-52.
[153] A. Ahlstrom Osakeyhti v. Commission, 1988 E.C.R. 5193, 4 Common Mkt. Rep. (CCH) § 14,491, at 18,612 (Sept. 27, 1988) [hereinafter *Wood Pulp II*]. Both the European Court of Justice and European commentators have attempted to maintain a distinction between the "implementation doctrine" applied in *Wood Pulp II* and the "effects doctrine" applied by U.S. courts. *See* EINER ELHAUGE & DAMIEN GERADIN, GLOBAL ANTITRUST LAW AND ECONOMICS 1137 (2007). In virtually all plausible scenarios, however, the two approaches are bound to lead to the same result. More likely, European insistence at maintaining the distinction parallels the series of pre-*Alcoa* U.S. antitrust cases formally requiring U.S. activities as a basis for jurisdiction, but nevertheless satisfying themselves with minimal contacts that were in no way central to the alleged violation. *See* ELHAUGE & GERADIN, *id.* at 1144; *see also* Andre Fiebig, *Modernization of European Competition Law as a Form of Convergence*, 19 TEMP. INT'L & COMP. L.J. 63, 81 (2005) ("The implementation requirement is simply another name for the effects test.")
[154] Gencor Ltd. v. Commission, Case T-102/96, [1999] ECR II-753, para. 90. Under *Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings* [hereinafter the EC Merger Regulation], proposed mergers and other "concentrations" between undertakings must be reviewed by the European Commission if it has a "Community dimension," *i.e.*, if the sales turnover of the undertakings concerned in Europe exceed certain thresholds. *See* EC Merger Regulation, art. 1. *Gencor* was decided under a 1989 predecessor regulation whose turnover criteria were similar to the ones in the 2004 EC Merger Regulation.

appear to have become obsolete.[155] Conversely, while European competition law now reaches foreign conduct with effects in the Union, it does not condemn European conduct whose effects are felt abroad.[156]

This approach parallels the contemporary development of U.S. law through judicial decisions and legislation, which entrenched the effects principle as a fundamental—and de facto exclusive—rule governing extraterritorial antitrust jurisdiction. First, despite earlier suggestions that the effects principle be tempered by a reasonableness requirement, the Supreme Court reaffirmed it the 1993 *Hartford Fire* case.[157] Second, Congress passed statutes confirming its lack of concern for effects abroad. The Webb-Pomerene Act[158] and the Export Trading Company Act[159] had long protected certain export cartels against antitrust suits. They were supplemented in 1982 by a more general legislative statement of U.S. antitrust jurisdiction: the Foreign Trade Antitrust Improvements Act (FTAIA).[160] As interpreted by the Supreme Court in *Hoffman-LaRoche v. Empagran*, the FTAIA "seeks to make clear to American exporters (and to firms doing business abroad) that the Sherman Act does not prevent them from entering into business arrangements …, however anticompetitive, as long as those arrangements adversely affect only foreign markets."[161] As a practical matter, the European and U.S. approaches to extraterritoriality have become mirror images of each other. Each authority vigorously enforces its laws against activities with effects on its markets, limited only by its practical capacity to gather evidence and enforce its

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[155] In *Gencor*, the German Government specifically submitted that the turnover criteria of the Merger Directive were justified under public international law by the effects principle. See *Gencor*, para. 74. At least one prominent commentator has concluded that, at least in the context of antitrust regulation, the effects principle is now generally accepted as a ground of jurisdiction. *See* Eleanor M. Fox, *Competition Law*, *in* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 345, 350 (2002) ("Jurisdiction over offshore acts that directly harm a regulating state, once the center of controversy, is now well accepted in the world.")
[156] *See* ELHAUGE & GERADIN, *supra* note 153 at 1156 ("A consequence of the 'territorial jurisdiction' principle applied in the EC, is that practices by European firms whose only impact is outside the EC fall short of the substantive reach of European competition law."). Elhauge and Geradin point out that there are exceptions to this rule in cases where export cartels create artificial scarcity in European markets or limit imports within the EC, but these exceptions are consistent with the argument of this Article. On mergers, the turnover threshold in the EC Merger Regulation effectively constitute a proxy for effects within the EC.
[157] U.S. enforcement agencies take a very broad view of the effects principle, which they take to include unsuccessful conspiracies abroad that would have had substantial effects in the United States and situations where the U.S. government is the purchaser, or funds the purchase, of goods and services abroad. *See* U.S. Department of Justice and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations (April 1995), para. 3.12, Illustrative Example B and para. 3.13.
[158] 15 U.S.C. §§ 61-66. The Webb-Pomerene Act exempts certain export associations from the principal substantive provisions of the antitrust laws in connection with exports from the United States to foreign nations, subject to certain filing requirements with the FTC.
[159] Relevant provisions codified at 15 U.S.C. §§ 4011-4021. The ETCA allows exporters to obtain a "certificate of review" from the Secretary of Commerce, certifying that their proposed activities will have no effects on trade within the United States. Once a certificate is obtained, the exporter' activities covered by the certificate are protected from criminal and civil actions under the antitrust laws. Even if the activities do not comply with the ETCA's requirements, the certificate protects the exporter against treble damages suits.
[160] 15 U.S.C. §§ 6a, 45(a)(3).
[161] 542 U.S. 155 (2004). *See also* ELHAUGE & GERADIN, *supra* note 153 at 1106-07.

processes against foreign enterprises. Conversely, both U.S. and E.U. law generally disregard anticompetitive activities conducted on their territory whose detrimental effects affect foreign markets. In a word, both competition regimes discriminate between domestic and foreign effects and use extraterritorial jurisdiction to protect their respective markets.

2. Procedural Cooperation, Policy Convergence and Rival Standards

A second consequence of the rise of Europe as a major international economic actor has been increasing competition between its antitrust regime and that of the United States.[162] Despite growing convergence, important differences persist on substantive issues such as vertical restraints and the evaluation of potential unilateral effects following a proposed merger.[163] More generally, European competition policy is often seen as more hospitable to noneconomic policy concerns—such as protecting certain categories of producers from competition or accommodating state-led cultural or industrial policies. There are also crucial differences between the blocs regarding antitrust enforcement: while U.S. authorities see private antitrust suits, treble damages and severe criminal penalties as essential deterrents, these methods are generally frowned upon in Europe, which relies primarily on public enforcement through civil penalties.[164] As a result, U.S. and E.U. laws have become "rival standards" that, particularly during the 1990s, competed actively to shape the emerging competition regimes, particularly in developing and post-Communist countries.[165] In particular, the EU's rapid expansion ensured the dominance of its competition model in the new democracies of Eastern Europe. Conversely, the United States model became increasingly influential within the U.S.'s immediate economic sphere, as illustrated by reforms of Mexican and Canadian antitrust laws in the shadow of North American free trade negotiations.

This rivalry, however, is kept in check by the fact that both the U.S. and the E.U., despite their assertion of extraterritorial antitrust jurisdiction over international business practices that affect their markets, frequently need each other's assistance to enforce their antitrust laws effectively. In addition, in an increasingly integrated transatlantic economy, both recognize the efficiency benefits of coordinating their policies and procedures in matters such as concurrent merger reviews. As a result, the U.S. and E.U.—along with several other important jurisdictions—have, since the early 1990s, pursued antitrust cooperation agreements that attempt to strike a delicate balance between, on the one hand, reaping gains from international cooperation and, on the other, preserving the distinctive substantive features of their respective regimes and retaining discretion to refuse or limit cooperation when genuine differences of policies exist or domestic political pressures make cooperation too costly.

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[162] *See* ELHAUGE & GERADIN, *id.* at iii.
[163] *See* Daniel K. Tarullo, *Norms and Institutions in Global Competition Policy*, 94 AM. J. INT'L L. 478, 490 (2000).
[164] *See* ELHAUGE & GERADIN, *supra* note 153 at 4.
[165] On the concept of rival standards, *see* DANIEL DREZNER, ALL POLITICS IN GLOBAL 78-81 (2007).

More specifically, the 1991 U.S.-E.C. Agreement[166] requires the parties to notify each other when their enforcement activities may affect their respective "important interests," to exchange information relevant to the other party's enforcement activities and render assistance related thereto, and to coordinate their enforcement activities when "it is in their mutual interest" to do so.[167] Most notably, the Agreement includes a "positive comity" provision by which each party can request that the other initiate enforcement activities in respect of anticompetitive practices carried out in the latter's territory and which adversely affect "important interests" of the former.[168] The Agreement also contains a "negative comity" provision in which the parties agree to "consider important interests of the other Party" in decisions relating to investigations or proceedings. In particular, when important interests of the other party are at stake, the parties agree to consider a series of balancing factors in deciding whether and how to proceed.

Several features of the Agreement, however, mitigate its cooperative implications. Thus, assistance is required only "to the extent compatible with the assisting party's laws and important interests" and is thus largely discretionary. In particular, none of the parties is bound or authorized to release confidential business information to the other without the consent of the private parties involved in the investigation or review.[169] Enforcement coordination is limited to "cases where both parties have an interest in pursuing enforcement activities," leaving each party free to withhold cooperation. The positive comity provision makes it clear that it does not "limit the discretion of the notified Party under its competition laws and enforcement policies as to whether or not to undertake enforcement activities with respect to the notified anticompetitive activities."[170] Likewise, the main obligation relating to negative comity is "to consider the following factors … in seeking an appropriate accommodation of the competing interests," a very low standard. Indeed, a commitment to refrain from extraterritorial enforcement would only make sense in the presence of a reciprocal commitment by the requested party to investigate but, as seen above, no such obligation is imposed by the Agreement.

Taken together, these qualifications strongly suggest that the purpose of the Agreement is limited to *coordinating* enforcement in cases where both parties share an

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[166] Agreement between the Government of the United States of America and the Commission of the European Communities Regarding the Application of their Competition Laws (1991).
[167] *Id.*, Art. II, III and IV.
[168] *Id.*, Art. V.
[169] *Id.*, Art. VIII, IX. *See* Devuyst, *supra* note 61 at 148. The 1995 Van Miert report stated that "it is clear that the ban on exchanging confidential information has created a major obstacle to close cooperation." Competition Policy in the New Trade Order: Strengthening International Cooperation and Rules, COM(95)359 final (Jul. 12, 1995) at 7, 14; *see also* Merit E. Janow, *Transatlantic regulatory cooperation in competition policy: the case for 'soft harmonization' and multilateralism over new bilateral US-EU institutions*, in TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 253, 255 (George A. Bermann et al. eds. 2000).
[170] The enabling statute for the most recent antitrust cooperation agreements entered into by the United States, the International Antitrust Enforcement Assistance Act, specifically conditions cooperation in individual cases on the Attorney General or the FTC's determination that such cooperation is "consistent with the public interest of the United States." 15 U.S.C. § 6207(a)(3).

interest in prohibiting anticompetitive practices adversely affecting both markets. For instance, if U.S. and European firms formed a transatlantic cartel to fix the price of a product in both markets, clearly both regulators would have a strong interest in pursuing enforcement action. In that case, the Agreement would be helpful because each regulator may need evidence from the other jurisdiction, to avoid imposing conflicting orders and remedies, and to avoid unnecessary duplication of costs for the regulators and businesses involved.[171] But just as clearly, the Agreement is not meant to compel a party to conduct enforcement activities against anticompetitive activities, such as export cartels, that externalize negative welfare effects onto foreigners.[172] Neither does it compel that party to provide assistance that would help the affected state effectively exercise extraterritorial jurisdiction, unless the requested party finds such assistance to be in its own interest. The emphasis on coordination is confirmed by the practical experience of regulators, who appreciate the benefits of mutual assistance but recognize that "bilateral agreements … remain limited in scope and effect."[173]

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[171] *See* Devuyst, *supra* note 61 at 132.

[172] The positive comity provisions of the 1991 Agreement were supplemented by a 1998 Agreement dealing specifically with this topic. *See* Agreement between the Government of the United States of America and the European Communities on the Application of Positive Comity Principles in the Enforcement of their Competition Laws (1998). The 1998 Agreement essentially provides for more detailed procedures for cooperation in cases where the requested party agrees to conduct enforcement proceedings. It does not, however, turn the discretionary standard of the 1991 Agreement into a binding one. Indeed, as stated by the U.S. International Competition Policy Advisory Committee:

> The historic enforcement record of antitrust agencies around the world does not instill confidence in those agencies' willingness to pursue antitrust actions against domestic firms in instances where the practices of those firms have allegedly impaired the ability of foreign firms to compete effectively. In the absence of a nation's serious commitment to undertake such actions, where legally warranted, the benefits of positive comity may remain modest or illusory.
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> INTERNATIONAL COMPETITION POLICY ADVISORY COMMITTEE, FINAL REPORT 23 (2000)

[173] *See* Communication from the Commission to the Council, Towards an International Framework of Competition Rules, COM(96) 284 final (June 18, 1996) at 8; *see also* Waller Weber, *supra* note 145 at 377.

These agreements are part of a broader set of international efforts at antitrust cooperation. The OECD maintains a set of recommendations for national antitrust authorities, last updated in 1995. *See* OECD, COUNCIL RECOMMENDATION CONCERNING CO-OPERATION BETWEEN MEMBER STATES ON ANTICOMPETITIVE PRACTICES AFFECTING INTERNATIONAL TRADE (1995), *available at* http://www. oecd.org/dataoecd/60/42/21570317.pdf. It also maintains a more recent set of guidelines on prosecuting hard-core cartels. *See* OECD, RECOMMENDATION OF THE COUNCIL CONCERNING EFFECTIVE ACTION AGAINST HARD-CORE CARTELS (1998), *available at* http://www.oecd.org/dataoecd/39/4/2350130.pdf. There is no doubt that these non-binding instruments and the many bilateral and regional agreements on antitrust cooperation have fostered significant improvements in coordination of enforcement activities across jurisdictions. For example, as in the case of securities enforcement, they have helped surmount domestic obstacles to international enforcement coordination, such as confidentiality laws and insufficient legal authority. *See* INTERNATIONAL COMPETITION NETWORK CARTELS WORKING GROUP, COOPERATION BETWEEN COMPETITION AGENCIES IN CARTEL INVESTIGATIONS (2006), available at http://www.internationalcompetitionnetwork.org/media/library/conference_5th_capetown_2006/CompetitionAgenciesInCartelInvestigations.pdf; *see also* Raustiala, *supra* note 5 at 57-58. However, as in the case of the U.S.-E.U. agreements, the OECD instruments expressly preserve each state's "full freedom of ultimate decision" in cooperating with foreign investigations. OECD, *id.*, art. 5(a); *see also* OECD, *id.*, art.

In practical terms, there are two main situations in which international antitrust cooperation is likely to break down: when the case involves a fundamental difference of substantive competition policy between the jurisdictions involved, and when one jurisdiction's treatment of the case is influenced, openly or not, by extraneous considerations such as protecting profitable cartels against foreign prosecution or, in the case of merger review, protecting "national champions" or strategic industries from foreign acquisition. The obvious problem is that it is very difficult to distinguish these two possibilities in specific cases, as illustrated by some of the most acrimonious Transatlantic antitrust disputes of recent years. The result, as illustrated most dramatically by the *Boeing/McDonnell Douglas* and *GE/Honeywell* mergers and the *Microsoft* case, is a situation where U.S. and E.U. regulators may differ substantially in their assessment of a case and participants on each side accuse the other of covert political motives.[174] It is fair to say that, to this day, international cooperative arrangements have not successfully addressed these kinds of disputes.

B. The International Competition Network

1. Origins and Accomplishments

In 1997, the Clinton administration convened the U.S. International Competition Policy Advisory Committee, a blue-ribbon panel of antitrust experts who were asked to provide recommendations for the future of U.S. international antitrust policy. In its influential 2000 report, the Committee, after taking stock of the current state of international cooperation, called for the creation of "a *new* venue where government officials, as well as private firms, nongovernmental organizations (NGOs), and others can consult on matters of competition law and policy."[175] As a result, the International Competition Network was launched in 2001 to "address antitrust enforcement and policy

2(c) ("a Member country may decline to comply with a request for assistance, or limit or condition its co-operation on the ground that it considers compliance with the request to be not in accordance with its laws or regulations or to be inconsistent with its important interests or on any other grounds, including its competition authority's resource constraints or the absence of a mutual interest in the investigation or proceeding in question.")

[174] In *Boeing/McDonnell Douglas*, the European Commission initially prohibited a merger between two large U.S. manufacturers of large passenger aircraft. It eventually approved the transaction after imposing much stricter conditions than those demanded by the United States. *See* Commission Decision 97/816 of 30 July 1997, Case No. IV/M.877—Boeing/McDonnell-Douglas, 1997 O.J. (L 336) 16. The Commission's role became controversial because of perception in the United States that it was unduly protecting the interests of Boeing's only remaining competitor, Airbus. *See* Eleanor M. Fox, *Mergers in Global Markets: GE/Honeywell and the Future of Merger Control*, 23 U. PA. J. INT'L ECON. L. 457, 467 (2002). In *GE/Honeywell*, the Commission prohibited a merger between two U.S. manufacturers of jet engines and avionics that had previously been approved by U.S. authorities. *See* Commission Decision 2004/134 of 3 July 2001, Case No. COMP/M.2220—General Electric/Honeywell, 2004 O.J. (L048) 1.

[175] INTERNATIONAL COMPETITION POLICY ADVISORY COMMITTEE, FINAL REPORT 282 (2000) (emphasis in original).

issues of common interest and formulate proposals for procedural and substantive convergence."[176]

The ICN's concise governing instrument makes it clear that, while the ICN will "encourage the dissemination of antitrust experience and best practices," it will not "exercise any rule-making function" and will leave it to individual antitrust agencies "to decide whether and how to implement the recommendations."[177] The ICN is nonhierarchical in nature and comprises several working groups focused on specific aspects of international antitrust policy (*e.g.*, cartels, mergers, unilateral conduct), whose work is coordinated by a steering group of representatives from national antitrust agencies. The ICN is intended to be as inclusive as possible, welcoming members from both developed and developing countries as well as non-governmental advisers from international organizations, industry and consumer groups, antitrust practitioners, and academics.[178] In May 2007, the ICN announced that its membership had reached 100 agencies from 88 jurisdictions.[179] The ICN does not maintain a permanent secretariat and much of its activity takes place at a yearly conference where recommendations and other important documents are officially adopted.

While it is much too early to evaluate the ICN's impact on international antitrust cooperation, some preliminary observations may be made. First, the ICN's creation appears to have created significant momentum in the international antitrust world, and its working groups have been more active in recent years than more formal forums such as the OECD, UNCTAD or the WTO. Most of the early activity dealt with procedural matters and capacity-building. Thus, the Cartels Working Group drafted several chapters of a manual on anti-cartel enforcement techniques that is being used by antitrust agencies around the world to enhance their investigatory capabilities.[180] The Merger Working Group has produced detailed recommended practices on merger notification and review procedures to help streamline the approval process for transnational mergers.[181] The working groups have also organized international workshops to build enforcement capacity and disseminate best practices. They also encourage informal assistance to newer agencies on technical aspects of their work.

At the same time, the working groups have been gathering comparative information on substantive aspects of national regimes, and—more recently and with evident caution—have initiated projects to promote substantive convergence. Thus, the Unilateral Conduct Working Group compiled an extensive report on the objectives of unilateral conduct laws, the approaches used by various agencies to define "dominance" as a threshold for intervention, and on state-created monopolies, and has published sets of

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[176] ICN, MEMORANDUM ON THE ESTABLISHMENT AND OPERATION OF THE INTERNATIONAL COMPETITION NETWORK 1 (2001).
[177] *Id.*
[178] *Id*. at 2.
[179] ICN, A STATEMENT OF ACHIEVEMENTS 1 (2007).
[180] *See id.* at 2; ICN, CO-OPERATION BETWEEN COMPETITION AGENCIES IN CARTEL INVESTIGATIONS (2007).
[181] *See id.* at 4.

recommended practices in the latter two areas.[182] It is also moving forward with reports on substantive antitrust analysis of specific unilateral practices—such as predatory pricing and exclusive dealing—based on which it plans to "consider work on a general framework for assessing conduct."[183]

The Cartels Working Group, for its part, released important reports on international anti-cartel cooperation and on the roles of public and private enforcement, as well as templates comparing national enforcement regimes.[184] Perhaps most remarkably, the Merger Working Group has produced guidance on crafting precise definitions of "merger" for purposes of notification requirements, as well as a set of recommended practices for substantive merger analysis.[185] While the document does not address more controversial substantive issues such as the assessment of potential unilateral and coordinated effects and their likelihood, the Working Group has placed these matters on its agenda for 2008-09.[186] In all these fields, there appears to be an ongoing and significant shift in focus from procedural matters and comparative studies to actively promoting substantive policy convergence. The practical impact of these initiatives, however, remains to be seen.

2. The ICN's Prospects

The historical background outlined above is crucial to understanding the prospects and limits of the ICN and other network-based approaches to international antitrust. When the world's major economic powers were divided by fundamental policy divergences, antitrust cooperation involved a zero-sum game. By way of example, either the United States succeeded in its unilateral efforts to break up a foreign cartel or it didn't. The cartel's home state, for its part, saw these efforts as direct attacks on its sovereign right to determine its internal economic arrangements. It resisted them through blocking statutes and other devices that directly prohibited state organs from cooperating with foreign antitrust enforcement, thus creating a legal climate overtly hostile to international cooperation. In contrast, gradual convergence between major economic powers on the fundamental premises of competition policy has now created a space where cooperation may be beneficial to both parties, leading to the adoption of bilateral cooperation treaties and other initiatives to coordinate the regulation of international business practices and mergers. These efforts have recently been complemented by the creation of the ICN.

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[182] *See* ICN, REPORT ON THE OBJECTIVES OF UNILATERAL CONDUCT LAWS, ASSESSMENT OF DOMINANCE/SUBSTANTIAL MARKET POWER, AND STATE-CREATED MONOPOLIES (2007); ICN, DOMINANCE/SUBSTANTIAL MARKET POWER ANALYSIS PURSUANT TO UNILATERAL CONDUCT LAWS (2008); ICN, STATE-CREATED MONOPOLIES ANALYSIS PURSUANT TO UNILATERAL CONDUCT LAWS (2008).

[183] *See* ICN, UNILATERAL CONDUCT WORKING GROUP 2008-2009 WORK PLAN (2008); *see also* ICN, REPORT ON PREDATORY PRICING (2008); ICN, REPORT ON SINGLE BRANDING/EXCLUSIVE DEALING (2008).

[184] *See supra* note 180.

[185] *See* ICN, RECOMMENDED PRACTICES FOR MERGER ANALYSIS (2008). The Recommended Practices, adopted by consensus, address (at a high level) the importance of a comprehensive and precompetitive legal framework for merger analysis, the use of market shares, thresholds and presumptions, and the role of potential entry and expansion in evaluating the competitive impact of proposed mergers.

[186] *See* ICN, MERGER WORKING GROUP 2008-2009 WORK PLAN (2008).

The question thus becomes, can the ICN build on these previous efforts and generate deeper international cooperation?

As illustrated by the failure of harmonization attempts and the weak obligations incorporated in bilateral treaties, governments have been reluctant to enter into deep and legally binding international antitrust commitments. Two distinctive characteristics of international antitrust help explain the limits of formal cooperation mechanisms. First, unlike other areas of international regulation where rules can be reduced to formal instruments and used to monitor compliance, domestic antitrust policy has since its inception been based on broadly-worded legal provisions that establish general principles meant to be applied in a highly contextualized manner by specialized agencies and by courts. Given the diversity and complexity of the factual situations faced by regulators, antitrust analysis often requires detailed understanding of specific markets embedded in broader national regulatory environments, which makes it difficult to capture in rules and formulae except at the most general level. In this context, consultations and development of common understandings through networking is often seen as an attractive alternative to largely fruitless attempts at drafting meaningful international rules.[187]

Second, the reluctance to establish deep legal commitments also reflects the unilateral roots of international antitrust. As described above, both the U.S. and E.U. competition regimes follow jurisdictional rules that exclude domestic anticompetitive practices that affect only foreign markets from the scope of their antitrust laws, while enforcing the same laws extraterritorially against foreign practices with effects on their markets. In this framework, bilateral cooperation agreements are designed, not to replace unilateralism, but to complement it by enlisting the assistance of foreign authorities in carrying out extraterritorial enforcement. While these agreements work in situations where state interests are aligned—for instance, when fighting international cartels whose net effects are negative in both jurisdictions or reducing duplicative transaction costs and delays for transnational mergers—regulators cannot bind themselves systematically to cooperate with foreign investigations or defer to their results, because they know that sometimes the targets will be practices that benefit their countries or are otherwise unassailable for domestic political reasons.[188] Examples of this include not only export

[187] *See* Tarullo, *supra* note 163 at 478-79, 482, 490.

[188] Both U.S. and E.U. antitrust authorities are required to act according to law and were designed to insulate them from political pressures. Nevertheless, they are held accountable to their respective political constituencies through regular oversight of their activities. FTC and Department of Justice officials frequently appear before Congress, and the EC competition commissioner is “regularly grilled” by the European Parliament. Devuyst, *supra* note 61 at 130. The Commission, while independent, nevertheless values good relations with European member states, whose votes on the Council of Ministers are necessary to bring its legislative proposals into law. Moreover, legal constraints also limit the ability of the Commission to act on its own initiative to deepen international cooperation. In 1994, the European Court of Justice held that the Commission had exceeded its jurisdiction by entering into the 1991 antitrust cooperation agreement with U.S. authorities, as only the Council has the power to bind Europe in international law. *See* Case C-327/91, French Republic v. Commission of the European Communities, Judgment of 9 August 1994, [1994] ECR I-3641; *see also* Corrigendum to Decision 95/145, ECSC of the Council and the Commission of 10 April 1995, Concerning the Conclusion of the Agreement between the European Communities and the Government of the United States of America Regarding the Application of their Competition Laws, 1995 O.J. (L 131) 38. While the agreement was subsequently ratified by the Council, the case confirmed the need to escalate binding cooperation initiatives from the Commission to

cartels, but also a range of situations where political considerations are alleged to result in weak antitrust enforcement, such as high-profile mergers involving loss of national control over politically sensitive industries or "national champions." In this light, the language of the bilateral treaties appears tailored to coordinate enforcement in the many cases where interests coincide, while preserving a pressure valve for noncooperation where powerful domestic constituencies oppose it.

Given this background, it may well be that networking through the ICN is the best, and perhaps the only realistic, option for progress on international antitrust cooperation. As seen above, the legal doctrines governing many areas of antitrust have converged to such an extent that differences emerge not from the rules themselves, but in the application of economic theories to analyze specific practices and industries. In this context, informal networking through the ICN can plausibly catalyze deeper convergence between the methods used by various national regulators. Another reason the ICN approach may be desirable is that, according to some international antitrust experts, greater harmonization has been impeded in the past by substantial uncertainties concerning its distributive effects.[189] Unlike a formal agreement on antitrust principles,

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the Council, thus reducing the experts' freedom of action vis-à-vis Europe's political authorities. Together, these pressures may make it impossible for regulators to agree to credibly commit themselves to sacrifice important national interests by refraining from unilateral action in reliance on a reciprocal pledge by the other.

[189] Anu Bradford hypothesizes that, even if harmonization would create joint gains, it may be impaired by a dual distributional and informational problem. In essence, states know that there will be winners and losers, but because the effects on their firms and consumers are hard to predict, they cannot agree *ex ante* on equivalent concessions in other areas. See Anu Bradford, *International Antitrust Negotiations and the False Hope of the WTO*, 48 HARV. INT'L L.J. 383, 413-32 (2007).

There is an extensive and unresolved controversy regarding the nature of the international antitrust cooperation problem, which is beyond the scope of this article. Notably, Andrew Guzman argued in an influential 2004 article that states' attempts to "externalize the costs and internalize the benefits of the exercise of market power across borders" distort their antitrust policy. Since uniformization of competition policy will impose different costs and benefits on net exporters and importers, Guzman argues that it cannot be pursued successfully in isolation from other international issues. Linkages with other international regimes, such as trade negotiations within the WTO, would allow the winners to compensate the losers so as to produce a mutually beneficial outcome. *Id*. at 371-74. *See* Andrew Guzman, *supra* note 150 at 357; *see also* Andrew Guzman, *International Competition Law* in RESEARCH HANDBOOK IN INTERNATIONAL ECONOMIC LAW 418, 430-32 (Andrew T. Guzman and Alan O. Sykes eds. 2007).

Other scholars argue at length that no such trend has been empirically verified, and that there are several reasons why this effect is unlikely to be significant, notably because trade balances fluctuate over time and international trade constitutes only a small percentage of the largest economies' GDP, overall antitrust policy is likely driven primarily by domestic considerations rather than by international trade balances. *See* ELHAUGE & GERADIN, *supra* note 153 at 1102; *See* Bradford, *id.* at 390-93; John O. McGinnis, *The Political Economy of International Antitrust Harmonization in* COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY 126, 136 (Richard A. Epstein & Michael S. Greve, ed. 2004); Michael J. Trebilcock & Edward M. Iacobucci, *National Treatment and Extraterritoriality: Defining the Domains of Trade and Antitrust Policy, in* COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY, *id.*, at 168-69; Eleanor M. Fox, *Antitrust and Regulatory Federalism: Races Up, Down and Sideways*, 75 N.Y.U. L. REV. 1781, 1790 (2000). Moreover, for many producers of goods, asset specificity is such that relocating production to foreign countries to enjoy laxer antitrust regulation would incur substantial costs and little benefit. *See* Wolfgang informal cooperation through the ICN may allow regulators to reduce such uncertainties by experimenting with different approaches and developing a sense of their economic impact without making binding commitments. One must recognize, however, that a very substantial degree of convergence had to happen due to exogenous factors in the absence of TRNs before reaching this stage.

C. Conclusions

Although it is too early to assess the impact of the ICN's efforts, there are reasons to be cautiously hopeful. It must be recalled, however, that any assessment of the ICN takes place within a broader historical context where expectations regarding international antitrust cooperation are limited by several factors. Because of the fundamentally unilateral nature of national competition policies, the inherent difficulty of harmonizing substantive antitrust law and practice, and the overhanging presence of domestic political pressures to use antitrust policy for national gain in specific cases, antitrust regulators recognize the practical limits of international cooperation. For instance, the idea of an optimal global competition policy based on deep substantive harmonization or reciprocal assistance commitments is widely seen as infeasible. Given the dispersion of antitrust authority within both the U.S. and E.U., complex internal bureaucratic disputes also complicate the prospects for greater cooperation.[190] Against this background, networking shines as an attractive alternative, but it remains to be seen whether the ICN succeeds in promoting further substantive convergence and reducing the incidence of conflicting decisions. In the meantime, the claims that international antitrust is "rife with informal cooperation" and that network regulation "avoids the race" between national competitors appear, although not devoid of foundation, somewhat premature.[191]

Kerber & Oliver Budzinski, *Competition of Competition Laws: Mission Impossible? in* COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY, *id*. at 48-49. On the importance of asset specificity for regulatory competition, *see* DALE D. MURPHY, THE LOGIC OF REGULATORY COMPETITION 16-20 (2004).

While I agree with the latter view that trade balances are unlikely to cause systematic variations in substantive antitrust policies, this conclusion does not banish the Prisoner's Dilemma from the realm of international antitrust. This becomes clearer if one recalls the distinction between the negotiation and enforcement stages outlined in Fearon's work. Thus, while Bradford is probably correct that the main obstacle to negotiating a agreement on substantive international antitrust rules resides in the coexistence of distributive and informational problems at the negotiation stage, there would also very likely also be significant problems at the enforcement stage. For instance, if uniform international antitrust rules were adopted, states would have incentives to underenforce them against anticompetitive activities that benefit their economy, while overenforcing them against those that harm their markets. These defections would be difficult to detect, especially given the inherent difficulty of formulating antitrust rules with sufficient precision to permit an objective determination of compliance while retaining sufficient flexibility necessary to allow domestic authorities to make the fact-intensive determinations essential to effective antitrust enforcement. If anything, the problem of uniform international antitrust is even more vexing than suggested by the already staggering difficulties described by Bradford.

[190] *See* Weber Waller, *supra* note 145 at 378-80.

[191] Slaughter & Zaring, *supra* note 111 at 217.

VI. REASSESSING REGULATORY NETWORKS

A. The Limits of Regulatory Networks

Based on these case studies, what conclusions can we draw regarding the role and importance of TRNs in global governance? At the outset, these cases invalidate the hypothesis that TRNs are, in essence, technocratic forums where specialized regulators settle complex issues of international regulatory cooperation free from domestic politics. Admittedly, this claim is rarely made in such absolute terms, but it nevertheless underlies the idea that regulators acting in TRNs can—and should—develop a dual loyalty to domestic interests and to "the rights and interests of all peoples."[192] Far from being removed from domestic politics, regulators are tied to them by multiple channels of accountability and incentives structures that should be expected to outweigh their loyalty to global interests.

The impact of domestic pressures on regulatory networks is most dramatically illustrated by instances of direct political intervention. The Basel II negotiations provide a vivid example—it is perfectly clear that Chancellor Schroeder would not have permitted German banking regulators to agree to rules that would harm small and medium enterprises, even if they had thought the policy would improve global financial stability. More significant, however, is that all three case studies demonstrate the weight of domestic interests in determining the positions individual national regulators adopt in TRNs and the eventual outcome. Thus, although financial stability is a global public good, negotiations on capital regulations played out very differently in the Basel Committee and IOSCO. Domestic pressures on U.S. and U.K. regulators to improve confidence in their financial system while preserving the competitiveness of their international banks motivated the adoption of the Basel Accord, while U.S. domestic resistance and a lesser sense of urgency doomed IOSCO's effort to establish rules for securities firms. Likewise, global efforts to enforce securities laws and combat money laundering faced resistance by OFCs eager to protect their domestic financial industry, until 9/11 raised the stakes and led FATF members to adopt a more coercive approach.

Importantly, the fact that regulators are bound to domestic interests does not mean that TRNs are unable to pursue collective aims. It means, however, that the clashes of state interests that generally hinder international cooperation efforts will also inevitably occur in TRNs. As a result, if one leaves aside pure coordination games, efforts by TRNs to establish global regulatory standards must address distributive and enforcement problems. The difficulty, however, is that TRNs lack the institutional capacity to respond effectively. As regulators generally lack legal jurisdiction to offer linkages or side payments, distributive problems may be "papered over" by diluting the substantive global standards, thus undermining their effectiveness at the outset. Thus, some Basel I rules adopted to secure broad agreement to the Accord—such as the flexible definition of capital and artificially low requirements for home mortgages and short-term loans to

[192] Anne-Marie Slaughter, *Disaggregated Sovereignty: Towards the Public Accountability of Global Government Networks*, 39 Gov't & Opposition 159, 163 (2004).

OECD countries and banks—favored investment in assets and countries that later were at the center of major financial upheavals. Had the Basel I rules been determined exclusively in relation to the objective of preserving global financial stability, these assets would likely have been treated less favorably.

The presence of distributive problems also creates opportunities for powerful states to secure their preferred outcome through incentives and threats, as illustrated by the imposition of money laundering and securities fraud rules on OFCs. On their own, there is little chance that OFCs would have agreed to take extensive steps against money laundering. Their cooperation was secured through threats of sanctions and loss of access to the markets on which their financial industry depends. In such cases, the resulting standards may be globally efficient, but powerful states will enjoy a disproportionate share of the benefits. This was also arguably the case when the United States and the United Kingdom maneuvered to secure adoption of the 1988 Basel Capital Accord. While the higher capital levels mandated by the Accord likely improved global financial stability, the Accord also allowed the two sponsors to maintain their competitive position despite the recapitalization they would have had to accomplish in any event.

In addition, given their lack of monitoring, dispute resolution or enforcement mechanisms, TRNs are ill-equipped to effectively address enforcement problems. Thus, the Accord adopted in 1988 by the Basel Committee gradually unraveled as national regulators adopted self-serving exceptions and interpretations, because the Committee had little effective leverage to enforce its rules. Similarly, while antitrust assistance agreements facilitate enforcement coordination when mutually beneficial, they painstakingly avoid commitments that would bind the two powers to act against important domestic interests in specific cases. IOSCO has likewise largely avoided adopting substantive rules that might be undermined by opportunism.

B. Networks and the Paradox of Global Governance

The existing literature suggests—but does not fully develop—two hypotheses regarding how TRNs might overcome these difficulties. First, although TRNs lack enforcement capabilities, market pressures may effectively compel states and private actors to comply with global standards once they are adopted. The paradigmatic example is the Basel Accord, as many commentators believe that open noncompliance by a developing country with bank capital adequacy rules would likely trigger capital flight and other severe market consequences.[193] This argument is based on a valid intuition, but it suffers from serious limitations. While it addresses the enforcement problem, it does nothing to solve the inevitable distributive issues that arise in negotiation; in fact, it likely aggravates them. If states know that markets will constrain them to comply with regulatory standards developed by TRNs, they will be even more hesitant to make concessions to reach an agreement.

More importantly, the argument that markets will enforce global standards is highly contingent on the circumstances of individual regulatory efforts. Market

[193] *See, e.g.*, SINGER, *supra* note 75 at 9-10; *see also* KAPSTEIN, *supra* note 85 at 13.

pressures may have favored compliance with the Basel Accord, but in another era they also destroyed the Bretton Woods fixed exchange rate system. Likewise, the WTO system, with its extensive dispute resolution and countermeasures mechanisms, is clearly designed on the basis that market incentives are insufficient to override domestic protectionist interests and achieve mutual trade liberalization. If markets systematically rewarded compliance with regulation, there would be little need for domestic regulatory enforcement—or indeed for any regulation at all beyond voluntary standards. Yet few of us would be satisfied with market-enforced, voluntary standards for food and drug safety, environmental protection or securities regulation. If market failures provide the theoretical justification for regulation in the first instance, it appears paradoxical to insist that market discipline will systematically compensate for the enforcement deficiencies of TRNs. At the very least, the claim that TRN standards are effectively enforced by the markets requires more theoretical development and empirical support.

The second hypothesis is that, by virtue of the ties created by the proliferation of TRNs, regulators are gradually becoming "socialized" into patterns of norms and expectations favoring the pursuance of international cooperation over parochial state interests. Thus, Slaughter contends, government officials—like "sheep farmers, diamond merchants and sumo wrestlers"—can develop and enforce collective norms without formal legal structures or enforcement capabilities.[194] By drawing attention to the importance of transnational social interactions between government actors in shaping international regulatory initiatives, Slaughter opens up the intriguing possibility that TRNs might function as an alternative mode of international governance alongside markets and formal hierarchies.[195] If this is indeed the case, the network of ties between national regulators may, over time, counterbalance their domestic constraints and foster greater cooperation than is in fact observed in contemporary case studies.[196]

Here again, several caveats are in order. There is no doubt that the literature on TRNs can draw important insights from the extensive and growing scholarship on social networks. One of the foundational principles of this scholarship, however, is that detailed empirical analysis of specific networks is necessary in order to draw conclusions regarding their effects in a given area. In particular, formal social network analysis involves difficult but crucial methodological issues. It typically begins by specifying the relevant actors ("nodes"), the nature of the links ("ties") between them, and "rigorously applying graph and topology principles to the data."[197] Beyond mapping networks, social network analysis attempts to draw conclusions by quantifying numerous factors including the centrality of actors, the relative density of parts of the network,

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[194] *See, e.g.*, SLAUGHTER, supra note 5 at 198.

[195] *See* Walter W. Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RESEARCH IN ORG. BEHAVIOR 295 (1990); Mark S. Granovetter, *The Strength of Weak Ties*, 78 AM. J. SOC. 1360 (1973); Mark Granovetter, *The Strength of Weak Ties: A Network Theory Revisited*, 1 SOC. THEORY 201 (1983).

[196] For instance, there is evidence that in certain economic contexts, the existence of social networks between participants in the production process may produce Pareto-efficient behavior that defeats "game theoretic predictions that relay on self-interested motives to explain cooperation." Brian Uzzi, *Social Structure an Competition in Interfirm Networks: The Paradox of Embeddedness*, 35 ADM. SCI. Q. 35, 55 (1997).

[197] DAVID KNOCKE, POLITICAL NETWORKS: THE STRUCTURAL PERSPECTIVE 9 (1990).

identification of "cores" and "peripheries," blocks and cliques of densely-related actors, and many others. Through both pictorial representation and quantitative analysis, "the structural analyst seeks to uncover the fundamental forms and processes of social and political behavior."[198]

It is plain that fruitfully applying this approach to TRNs would require extensive study of specific networks and a thoughtful and cautious approach to the methodological issues, some of which are particularly vexing in the context of transnational regulation. Are the relevant actors states, regulatory organizations, or individual officials? What is the nature of the ties that should be studied? Are we interested in—among other possibilities—official cooperation arrangements, common membership in TRN governing boards or specialized committees, common attendance at conferences or participation in rulemaking processes, or personal links of acquaintance or friendship? Once the actors and ties are identified, what are the boundaries of the network? If, as one might expect, the boundaries are set so as to focus on the emerging transnational ties between regulators, is there not a risk of ignoring or downplaying the impact of the much more numerous social links between regulatory officials and the domestic industries they spend much of their time inspecting and overseeing—and where they often spend part of their careers through the "revolving door" phenomenon? Given a clearly defined network, what is the nature of the causal relationship to be identified? Are we interested on the causes or effects of TRNs? In compliance with their output or their effectiveness in addressing concrete problems?[199] These examples are, by necessity, only a sample of the threshold methodological issues the TRN literature would have to address to draw rigorously on social network analysis.[200] Slaughter and other advocates of TRNs, however, do not engage this scholarship directly or draw on its techniques to conduct a systematic analysis of TRNs. Instead, they rely on social network analysis in a metaphorical or heuristic sense, an approach that, in the words of two network sociologists, produces studies which "look promising a first glance, but their contributions are slight and scattered."[201]

This approach is problematic in light of the fact that, as leading social networks scholars point out, particular instances of networking can have perverse effects. In an influential discussion of the role of social networks in economic life, Mark Granovetter, after rejecting the dichotomous positions that economic order is supported either by institutional constraints or general morality, insists that he is not "rejecting one kind of optimistic functionalism for another, in which networks of relations, rather than morality or arrangements, are the structure that fulfills the function of sustaining order."[202] Thus,

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[198] *Id*.
[199] On a more fundamental level, one might also question whether the social network paradigm is appropriate to the study of the more formal TRNs (such as the Basel Committee and IOSCO), which have fairly elaborate organizational forms including formal membership rules, deliberations and decision-making structures, and that produce written standards and recommendations.
[200] For a much more comprehensive critique of the TRN literature from a methodological perspective, *see* Jens Meierhenrich, *A Social Theory of International Law*, Working Paper, Harvard University, December 15, 2007 (on file with the author).
[201] ALAIN DEGENNE & MICHEL FORSE, INTRODUCING SOCIAL NETWORKS 12 (2d ed. 1999).
[202] Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness*, 91 AM. J. SOC. 481, 491 (1985).

according to Granovetter, not only do networks "penetrate irregularly and in differing degrees in different sectors of economic life, thus allowing for what we already know: distrust, opportunism and disorder are by no means absent,"[203] but sometimes they also actively foster these phenomena. "While social relations may indeed often be a necessary condition for trust and trustworthy behavior," he pursues, "they are not sufficient to guarantee these and may even provide occasion and means for malfeasance and conflict on a scale larger than in their absence."[204] Thus, the mutual trust created by social links can create new opportunities for malfeasance; networks can help sustain cooperative relationships among actors pursuing undesirable goals; and certain configurations of social relations can promote conflicts by creating rival coalitions.[205] The double-edged nature of social networks also infuses Granovetter's challenge of the assumption of efficacy of hierarchical power within organizations, where he points to studies showing how networks of social relations between employees effectively undermined the internal auditing and accounting policies of their firm, and thus its economic efficiency.[206]

The implications of these two deficiencies of TRN scholarship—its lack of systematic empirical support and its inattention to the potential perverse effects of social networking—undercut its ability to draw on social network analysis to buttress its argument that TRNs improve global governance. In particular, the latter deficiency raises the troublesome possibility that the increasing social connections between regulators might facilitate cooperation in pursuance of self-interested objectives rather than the public good,[207] while the former prevents any definitive judgment on the actual effects and merits of the social connections created by specific TRNs. One might object that the study of TRNs is in its infancy, and that the existing literature has had the merit of indicating the need for further, more specific research. While this is true, it is hardly consistent with Slaughter's enthusiastic recommendation that TRNs be "embraced" as "the architecture of a new world order."[208]

The paradox of global governance described by Slaughter is real, but her claim that TRNs can escape it is overstated. Obviously, TRNs could in theory develop institutional mechanisms to effectively overcome distributive and enforcement problems. Countries could expand the jurisdiction of their regulators in order to facilitate international linkages; they could free regulators to pursue global interests by loosening

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[203] *Id*.
[204] *Id*.
[205] *Id*. at 491-93. In a social network analysis of IGO relationships between states, Hafner-Burton and Montgomery note that "[s]ocial network literature on conflict in general demonstrates neither universally positive nor negative effects on aggressive behavior," and find evidence to support their hypothesis that "IGO social networks are similarly complex; they can and do increase and decrease conflict behavior for different state members under different circumstances." Emilie M. Hafner-Burton & Alexander H. Montgomery, *International Organizations, Social Networks and Conflicts*, 50 J. CONFLICT RES. 3 (2006).
[206] *Id*. at 499-500. Granovetter refers specifically to Dalton's study of cost accounting at a large chemical plants, where department managers were frequently tipped of "surprise" inventory audits and cooperated in hiding parts, equipment and materials to each other's facilities and other inaccessible locations, and to Eccles' account of the internal politics involved in pricing and accounting for transfers of products and services between different divisions of a single firm.
[207] On this point, see the discussion of public choice theory in Section VI.D, *infra*.
[208] *Id.* at 213.

their accountability structures; and they could encourage TRNs to set up stronger enforcement mechanisms. This would make TRN governance more effective, but would also bring it closer to a world government structure, with underspecified democratic accountability mechanisms beyond the multiple weak vectors proposed by the global policy networks literature. TRNs do not eliminate the tensions between effective global governance, subsidiarity and democratic accountability. They provide too fragile a foundation on which to build "the architecture of a new world order."[209]

C. Networks and Soft Law

Importantly, none of these considerations imply that TRNs lack a proper place in the constellation of global governance mechanisms. For instance, the largely successful coordination of securities fraud and money laundering enforcement among developed countries illustrates the usefulness of TRNs in addressing regulatory coordination problems. The effectiveness of independent national regulation was challenged by exogenous events, including technological developments and the globalization of financial markets. TRNs allowed national authorities to coordinate their response and achieve their common objectives. Likewise, the United States and Europe entered into limited antitrust enforcement agreements that facilitate coordination but preserve national autonomy in cases where "important national interests" diverge. Beyond enforcement coordination, TRNs have proved useful in several contexts where state interests are largely aligned, such as collecting and disseminating reliable information, developing best practices, and building regulatory capacity in developing countries.

These successes of TRNs, alongside the limits described above, point to the possibility of a theoretical account of TRNs that eschews excessive optimism in favor of a pragmatic understanding of the circumstances under which networks can effectively promote international regulatory cooperation. The recent literature on "soft law" indicates that there are several reasons why states seeking to cooperate may rationally avoid resorting to legally binding agreements.[210] Thus, states often favor informal agreements in areas where uncertainty is high, because they retain more flexibility to modify the agreement in light of changed circumstances. Since they signal a lower degree of international commitment than formal agreements, divergences in preferences among states are easier to bridge and the reputational costs of breach or withdrawal are smaller. They can also be concluded quickly, because they are not subject to the same domestic ratification procedures as treaties and have a lower public profile. The main drawback of informal agreements relative to treaties is that, since the reputational costs and enforcement mechanisms are weaker, informal commitments are less credible and less likely to constrain opportunism by states.

This essentially functionalist account of international soft law is a useful starting point for a rationalist account of TRNs, because many of the characteristics of the

[209] SLAUGHTER, *supra* note 5 at 213.
[210] *See, e.g.*, Charles Lipson, *Why Are Some International Agreements Informal?*, 45 INT'L ORG. 495 (1991); Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, *in* LEGALIZATION AND WORLD POLITICS 37 (Judith L. Goldstein et al. eds. 2001).

former—flexibility, speed, facilitating compromise—are also associated with the latter. The two phenomena are also linked by the fact that TRNs often adopt regulatory standards in the form of non-binding instruments such as the Basel Accord and the IOSCO MMOU. The case studies developed in this article point, however, to two important qualifications to the functionalist account of soft law. First, as demonstrated by Kal Raustiala, the account developed by Lipson, Abbott and Snidal is insufficient to explain the prevalence of formal international instruments unless supplemented by an examination of the domestic demand for international cooperation.[211] Raustiala's argument is consistent with the findings of this article regarding the role of domestic pressures in shaping the preferences that national regulators take to TRN negotiations.

Second, and more importantly, the functionalist literature insufficiently emphasizes that, while it may be rational for states to act through informal networks and agreements in certain circumstances, this does not mean that the results constitute an optimal regulatory outcome from a collective standpoint. While these authors make no such claim, their theoretical framework as it stands is too easily enlisted to support an overly optimistic outlook on international regulatory cooperation. Based on the hypotheses that "technical areas" of international regulatory cooperation exhibit low risks of opportunism, a need for expertise, secrecy, speed and flexibility, and less pressure from domestic interest groups who usually favor treaties over informal agreements,[212] widespread use of informal networks and agreements seems like the natural—and optimal—outcome.

The reality of international regulatory cooperation is less tidy. It is true that cooperation efforts initiated by TRNs and embodied in informal instruments "are often coordination problems,"[213] but this is precisely because TRNs generally avoid ambitious, substantive efforts at regulatory harmonization that would require sacrifice of short-term domestic interests and create enforcement problems they could not handle effectively.[214] It is also true that informal cooperation can often produce some agreement despite divergent state preferences, but this observation misleadingly suggests that papering over differences with a vague or unenforceable agreement—possibly aimed at appeasing vocal domestic constituencies—constitutes effective global governance. While informal cooperation may well be optimal in cases where mere coordination is needed, it would be rash to discount the likelihood that it serves as a second-best alternative in many situations where deeper regulatory cooperation would be optimal but no instrument exists that adequately reconciles the needs for speed, flexibility and compromise with the mechanisms needed to overcome distribution and enforcement problems.

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[211] *See* Kal Raustiala, *Form and Substance in International Agreements*, 99 AM. J. INT'L L. 581 (2005).
[212] *See, e.g., id.* at 600.
[213] *Id.*
[214] One important exception is the Basel Accord, which constituted a major attempt at substantive harmonization by informal means. However, as discussed above, it gradually unraveled due to enforcement problems. The choice of informal cooperation in that case was likely motivated by the high demand for speed by the Accord's principal proponents and their concern with achieving immediate results (i.e., reducing the competitive advantage enjoyed by Japanese banks) rather than controlling longer-term opportunism.

D. Networks, Global Administrative Law and Public Choice

One of the consequences of the growing visibility of TRNs has been to raise concerns regarding the transparency and accountability of network rulemaking in comparison with national regulatory processes. Thus, recent scholarship on the globalization of administrative law views favorably the implementation of notice and comment and other accountability procedures in international rulemaking.[215] Michael Barr and Geoffrey Miller argue that the extensive consultation process undertaken by the Basel Committee to revise its capital accord "could be a model for international rule-making with greater accountability and legitimacy."[216] The original Basel Capital Accord and its 1996 amendments were the results of confidential international negotiations and were presented for comments in the United States after they had been finalized by the Committee and endorsed by U.S. regulators. This led to complaints that the normal regulatory process had been circumvented by effectively presenting the Accord as a *fait accompli* and limiting the scope of public comments to the Accord's implementation rather than its content.[217] In contrast, the Basel II adoption process incorporated several rounds of drafting, hundreds of public comments, and fundamental revisions to the original proposal.

Barr and Miller's position is understandable. Admittedly, international rulemaking can hardly be legitimate without some accountability mechanisms. Better process may also, as Zaring argues, strengthen the resulting norms against domestic judicial review.[218] One may wonder, however, whether implementing extensive procedures modeled on domestic administrative law will destroy—or at least dilute—the very informality, speed and flexibility that are said to be the main benefits of TRNs. At the very least, the extensive delays experienced by Basel II call into question the idea of simply mirroring domestic notice and comment procedures, as the result may be an endless gauntlet of public review: first at the international level, and then domestically within each participating state. More importantly, while praising the Basel II consultative process, Barr and Miller show little interest in evaluating its actual output. From their standpoint, the superposition of international and national regulatory processes leads to desirable national variation which, as long as it is "consistent with the essential principles of a global standard," can enhance its legitimacy and practical reach.[219] But when states face a cooperation problem, as in the case of global capital standards, national variation and regulatory discretion may be symptoms of an ineffective regime. If, as argued above, Basel II's substantive weaknesses aggravate some of the flaws in the original Accord, it may be that greater accountability and transparency were purchased at the price of the "essential principles" the revision was meant to promote.

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[215] See Barr & Miller, *supra* note 53; Benedict Kingsbury, Nico Krisch and Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 15, 34-35, 37-39 (2005); Daniel C. Esty, *Good Governance at the Supranational Scale: Globalizing Administrative Law*, 115 YALE L.J. 1490, 1530-34 (2006).
[216] Barr & Miller, *supra* note 53 at 17.
[217] *See* Zaring, *supra* note 13 at 574.
[218] *See id.* at 600.
[219] Barr & Miller, *supra* note 53 at 31.

Finally, an important dimension of international regulatory cooperation that has not been explicitly explored in this article is the agency problem caused by delegation to regulators. I have hypothesized that, in most cases, domestic legal and political controls are sufficiently strong to align the actions of national regulators with prevailing domestic interests. This hypothesis appears to fit the case studies. Nevertheless, a substantial body of public choice theory suggests that regulators—like other governmental actors—act according to self-regarding incentives, with results that may be detrimental to the welfare of their constituents. The nature and effects of this agency problem are notoriously difficult to identify or measure. Bureaucrats may strive to maximize their agency's budget or their discretion.[220] In both cases, predictions have proved hard to make and to confirm empirically.[221] In the context of international regulatory cooperation, these problems are compounded by the multiplicity of national regulators facing different domestic constituencies, incentives and constraints.

Public choice scholars have suggested that TRNs may be vehicles for domestic regulators to advance initiatives that would not be politically feasible without outside support. While this may be beneficial in some cases, it may also allow regulators to create a common front to expand their bureaucratic power in their respective states, to the detriment of their constituents' welfare.[222] This possibility raises additional concerns when one considers the phenomenon of "regulatory capture," by which, through constant lobbying and revolving-door policies, regulators come to identify their interests with those of the industry they regulate.[223] While these considerations do not support definitive conclusions about the implications of public choice theory for TRNs, they suggest a paradox. On the one hand, if networks are effectively held accountable through domestic legal and political constraints, then their contribution to global governance will be limited. On the other hand, the more domestic autonomy they have, the more likely they are to enhance international enforcement and harmonization of standards—but also to act in ways that reflect the self-interest of regulators rather than aggregate welfare.

CONCLUSION

The pioneers of regulatory network scholarship have made an important contribution to the international law and international relations literature by attracting attention to a significant and unrecognized phenomenon. Despite the lack of systematic empirical data, there can be little doubt that the activities of TRNs have expanded considerably in the past decade. As a theoretical matter, network solutions may usefully address some of the problems caused by decentralized national regulation in an era of economic globalization. It is also plain, however, that TRNs cannot single-handedly

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[220] *See, e.g.*, WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971); Jean-Luc Migué & Gérard Bélanger, *Toward a General Theory of Managerial Discretion*, 17 PUB. CHOICE 27 (1974); Paul G. Wycoff, *The Simple Analytics of Slack-Maximizing Bureaucracy*, 67 PUB. CHOICE 35 (1990).

[221] *See* Edward L. Rubin, *Public Choice and Legal Scholarship*, 46 J. LEGAL EDUC. 490, 496 (1996).

[222] *See, e.g.*, Enrico Colombatto & Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and the Decline of the Nation State*, 18 CARDOZO L. REV. 925 (1996-97).

[223] *See, e.g.*, Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON & ORG. 167 (1990).

resolve the many paradoxes of global governance. Like any policy instrument, their full potential can only be realized when their benefits and limitations are recognized and incorporated in the plans and expectations of international actors. After all, some of the most optimistic advocates of TRNs recognize that power relations continue to operate in networks[224] and that the structure of specific international regulatory problems affects their effectiveness.[225] The challenge, however, is to conduct the detailed case-by-case analysis that will reveal under what circumstances TRNs produce effective regulatory cooperation, and distinguish them from areas where informal cooperation leads to shallow and suboptimal results.

In sum, this article calls for research on TRNs to turn away from overambitious claims of their transformative potential and towards a more cautious approach. The difficulties encountered by TRNs faced with distributive and enforcement problems reveal the limits of their contribution to global governance. The domestic legal and political constraints they face and the role that international power relationships play in their activities show that TRNs are, in essence, an extension of traditional politics. Clearly, states may choose to interact through networks in complex regulatory areas where speed, expertise and flexibility are essential and many issues can be addressed through simple coordination. The intrinsic institutional limitations of TRNs, however, make it unlikely that, without fundamental institutional changes, they will build upon these existing successes to secure effective cooperation when state interests diverge. On the contrary, the cases suggest that TRNs will eventually exhaust their potential, and the Basel Accord may well become the high-water mark of rulemaking by regulatory networks. This may not be apparent in the short run—TRNs are a relatively new phenomenon, and there may be substantial gains still to be achieved from coordination and information-sharing. Nevertheless, hopes that TRNs may create "a genuinely new set of possibilities for a future world order"[226] will likely remain elusive.

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[224] *See* Slaughter & Zaring, *supra* note 111 at 218.
[225] *See id*. at 220.
[226] SLAUGHTER, *supra* note 5 at 6.