Regulatory Capabilities

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Abstract:
This paper introduces the concept of “regulatory capabilities” which we define as the ability to regulate, not only be regulated. The concept builds on the notion of individual capabilities and extends it to the institutional framework within which individuals realize their capabilities. It provides a normative framework for assessing whether all stakeholders that are implicated by a given regulatory regime – public or private -- have a voice in is making. We argue that in the context of globalization and the rise of non-state regulators the concept offers several advantages: First, it shifts attention from states to emergent transnational regulatory regimes that are neither entirely public nor private. Second, it emphasizes that any regulatory regime potentially has regulatory effects. Third, it insists that the ability regulate not only to be regulated is has distributional effects on collectives however organized. This approach does not take regulatory goals as given, but asks who sets them and whose capabilities they advance.

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I. Introduction

In this paper we develop the concept of regulatory capabilities. We define regulatory capabilities as the framing of a regulatory domain and establishing the ground rules for governing it. It is well established that agenda setting is critical for influencing outcomes – whether in politics, business organizations or other settings. Identifying what it is that shall be regulated and specifying the regulatory goals determines the game that will be played.\(^2\) Specifying the rules of the game is only the second step, though this too is an important expression of regulatory capabilities. By establishing the ground rules for exit and entry and for changing a regulatory regime over time actors structure the space within which regulators and regulated will operate.

Regulatory capabilities are an expression of self-governance and self-governance is an expression of freedom – a normative goal that, in the words of Amartya Sen, is the ultimate goal of development (Sen 1999). Regulatory capabilities reflect a collective freedom that is distinct from, though interdependent with, individual freedom. In contrast, most debates on regulation focus less on freedom – which is regarded as curtailed by regulation in any event – and more on regulatory efficiency. Efficiency is concerned with the costs of regulation relative to its benefits from an aggregate social welfare perspective. In its most narrow iteration the efficiency perspective calls for regulation only in the event of market failure. It is primarily outcome-driven and largely oblivious to distributional consequences in the narrow sense. It matters little who makes the rules and who is subjected to them as long as the net social benefits exceed the net social costs (Kaldor-Hicks efficiency). In contrast, the regulatory capabilities approach suggests that who makes the rules and for whom matters irrespective of their efficiency because this affects if and how different constituencies can set their own priorities and express their values.

The regulatory capabilities approach also offers a different perspective on debates that are concerned with regulation's distributional effects. Power and wealth feature prominently in these debates. The concept of regulatory capabilities is related to both power and wealth, but not in a simple causal fashion. Wealth and power can be important determinants of regulatory capabilities, but they are not the only ones. Conversely, regulatory capabilities may have wealth and power implications, but not necessarily or exclusively. Indeed, depending on the theory of power one adopts regulatory capabilities can be viewed as synonymous with power, not only a reflection of existing power relations.

The regulatory capabilities approach is closely related to the individual capabilities approach developed by Amartya Sen, Martha Nussbaum and others (Sen 1985) (Nussbaum 2003) (Nussbaum 2011). The individual capabilities approach holds that a society is a just society only to the extent that it enables its members to live

\(^2\) See North (1990) who has argued that institutions are “the rules of the game”. Interestingly, he takes the game itself as given.
the lives they value. Individual capabilities within their framework are said to be innate, but their realization depends on the institutional and political environment in which an individual finds herself. The individual capabilities approach posits an obligation that individuals shall be enabled to realize their capabilities. The critical question from our perspective is, an obligation on and for whom? As will be further explored below, Nussbaum regards the state as the primary bearer of this responsibility (Nussbaum 2011). In contrast, we seek to cast the web wider since we are primarily concerned with transnational regulation where states often compete with other regulators for prominence. Moreover, we are concerned not only about the individual, but also about collectives. Humans are social beings and realize most of their rights and aspirations as part of collectives. Denying individuals the ability to organize and express collective aspirations denies them much of their freedom. Conversely, denying collectives however organized the right to express their own preferences undermines their ability to advance their own goals as well as those of the individuals they represent or serve.

The regulatory capabilities approach is meant to be an analytical as well as a policy tool. Several international organizations have developed concepts and regulatory toolboxes that are related to our concept of regulatory capabilities. They include the UN’s notion of capacity development and empowerment and the OECD’s regulatory capacity building approach. As we will further explain in this paper, the regulatory capabilities approach differs from these approaches in at least two respects: It places greater emphasis on the framing of regulatory domains, that is, the question as to what shall be regulated. Moreover, it asserts that in the interest of freedom and self-governance the framing and making of regulation should be contested. In policy circles it is often asserted that building regulatory capacity is a win-win game: It enables less developed countries to catch up with the more developed ones and ensures that they can partake in global trade and commerce on equal footing. That assumes that there is only one game in town, and further, that it is irrelevant who makes these rules. In contrast, we argue in this paper that the lack of contestation of regulatory principles this approach entails may disadvantage rule takers in this game. Moreover, it limits regulatory competition as a source of regulatory innovation.

The paper will proceed as follows. Section II develops the concept of regulatory capabilities. Section III analyzes its relation to power and wealth. Section IV discusses the policy implications of this concept and delineates it from related concepts, such as capacity building or capacity development. Finally, Section V explores the possibility of developing a regulatory capabilities map: A representation of regulatory regimes and their impact on regulatory capabilities of different stakeholders in different regulatory domains.
II. From Individual to Regulatory Capabilities

Amartya Sen argued powerfully that economic growth is a means to an end, not an end itself. The end of development is individual freedom (Sen 1999). Importantly, and in contrast to natural law theories and their progeny, that freedom cannot be assumed. The conditions for it are man-made and must be created. Political orders and institutional arrangements are critical for creating the conditions under which individuals can pursue their freedom, for promoting their realization, or for their denial. The notion that freedom cannot be derived from the state of nature but that instead it is contingent on laws, regulations, institutions and organizational practices shifts the focus from the protection of freedoms that precede the state, the classic notion of ‘negative’ civil and political rights, to the conditions for their realization. In this view, even the most negative rights are positive rights in the sense that they are contingent on factors beyond the control of the individual.

Martha Nussbaum has taken the debate a step further by developing a list of individual capabilities (Nussbaum 2003). They include the ability to lead a normal life, preserve one’s bodily integrity, engage in practical reasoning, live with others, among others. Only societies that put all their members in a position to realize these capabilities in principle – i.e. enable them to achieve minimum levels of education, protect them from harm and give them access to health care, nourish institutions and organizations that foster different forms of affiliation, among others – can be called just (Nussbaum 2011). For her, the obligation to create the conditions within which the realization of these capabilities is feasible falls squarely on the nation state. Writing in 2011 she asserts that even in our globalized world the nation state is the addressee of the moral obligation to create the conditions for justice.

We believe that this view is too narrow, primarily for two reasons: First, treating states as the primary obligor of individual capabilities assumes that each state’s ability to do so is of its own making. Yet, states themselves are embedded in global legal and regulatory structures that influence if and how they can deliver conditions that are conducive to individual capabilities. Global trade and investment regimes have different effects on different states depending on their economic and political preconditions, i.e. whether they are exporters or importers, havens of cheap labor, or hosts of outbound investment flows, centers for finance and technology development or in need of drugs to treat epidemics such as Malaria or HIV AIDS. Second, states are no longer (if they have ever been) monopolists in the shaping and making of regulatory regimes. Business associations, global supply chains, non-governmental organizations, including those that represent state regulators but not their legislatures are important contenders as rule makers in the transnational realm (Büthe and Mattli 2011). Placing the burden for providing the conditions for individual capabilities exclusively or primarily on states is therefore in danger of shortcutting a debate that should be integral to the analysis of individual capabilities: Who is in a position to frame regulatory regimes that may or may not enable individuals to realize their capabilities? Are their interests aligned with those affected by the regulatory regimes they devise? Under what conditions do framers
develop other-regarding preferences in a world that lacks traditional forms of political accountability? And what are the distributional effects of different regulatory regimes on the ability of individuals and/or groups to make their own choices about the lives they wish to live.

Asking these questions does not eliminate states as an object of inquiry. In fact, the literature on transnational private regulation has pointed out the manifold ways in which regulatory regimes that are devised and maintained by non-state parties interact with and are dependent on states (Cafaggi 2011). States delegate rulemaking authority to non-state parties or authorize them ex post facto. States dismantle state-made rules and allow private regulatory regimes to emerge. Last but not least, states often lend their coercive powers to private regulatory regimes. They very often do so, or are advised to do so, in the name of efficiency. Participants are better experts than government officials and have a real stake in the undertaking that is being regulated.

The regulatory capabilities approach urges a broader assessment by asking what is the relative impact of regulatory regimes that are framed and shaped by some on others. In this paper we use the term stakeholder to identify all those who have a vital interest in a regulatory regime. They may be competing regulators, the regulated, other groups, communities, organizations, or individuals that are affected by regulatory regimes. The lowest common denominator of stakeholders of any regulatory regime is that they share the costs in the event a regulatory regime fails. We intentionally adopt an open-ended terminology so as not to preclude from the landscape of regulatory capabilities those whose current organizational form does not fit a particular. However, as we will further discuss below, the ability to organize a collective voice is a critical condition for realizing regulatory capabilities. A major challenge for policy organizations therefore is to create enabling conditions for this to happen.

The regulatory capabilities approach thus offers a normative framework for assessing different regulatory regimes. A given regime may be more or less conducive to others expressing their regulatory preferences -- whether collectively or individually – and thus encourage contestation. We assert that from a freedom perspective, regulatory regimes that offer more rather than less choice, more rather than less contestation are preferable.

Any form of regulation that is not ‘self-regulation’ in the strictest sense, i.e. that affects only the regulators themselves with no effect on non-members, will affect others. That is the very purpose of regulation: The creation of a set of rules that will apply to all wishing to engage in certain activities. It follows that regulatory capabilities are a property not of an individual, but of a collective. And this in turn

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3 A perhaps clearer, though more restrictive, framing would divide the world into individuals, states and communities and analyze the regulatory capabilities of states and communities on one hand, and the individual’s capabilities on the other.
presupposes the ability to garner support and harness the capacity of a group of actors to establish and maintain a regulatory regime.

This then raises the question of how inclusive a regulatory regime should be. We suggest that this question cannot be answered in the abstract. It ultimately depends on the effect the regulatory regime has on others, groups as well as individuals, who are affected by it and who might have different regulatory preferences or the simply desire to regulate themselves rather than being regulated. This implies that the end of regulation (effective regulation, profit maximization, etc.) does not justify all means. Instead, the quest to regulate has to be measured against that of others to regulate as well; and that quest becomes more important when denying others the chance to participate in a regulatory regime seriously impedes the realization of the regulatory capabilities of all who are affected by that regime.

Within the framework of nation states this other-regarding principle has been institutionalized, however imperfectly, in the form of political processes as well as in judicial review. In the transnational realm only few mechanisms have been institutionalized. An example is investor-state arbitration, which allows private parties who may have been negatively affected by public regulation in the host country to sue that state for liability on the grounds that they are discriminatory, expropriating, or unfair. The around 3000 bilateral investment treaties that frame these disputes do not leave room for balancing the interests of foreign investors with those of other domestic stakeholders but preference investments over other interests. That is precisely the purpose of this mechanism: to dis-embed the regulatory regime for protecting foreign investments from local political processes in the host country. The standard argument in favor of this regime is one based on efficient outcomes: Local constituencies trade their voice in the making of regulatory regimes for higher volumes of foreign direct investments (Franck 2007). From our perspective, this is an insufficient justification. Even if better investor protection did indeed cause more investment inflows, which is a big if (Swenson 2006), it imposes costs on local stakeholders who may, for example, value environmental protection over foreign direct investment, yet are effectively restricted from realizing those preferences by the threat of liability.

BITs also include mechanisms for state-state arbitration. However, they are much less frequently used. More generally, while states find themselves increasingly in the role of “the regulated”, they have remarkably few options to contest transnational regulatory regimes, whether public and private. One reason is related to the way in which states are regulated. The regulation of state actions (both public and private) takes primarily the form of soft law, or new governance technologies such as indicators (Davis, Kingsbury, and Marry Engel 2010), which by definition don’t provide for legal remedies. Example for the former include international standards for regulating banks (Kapstein 1996); and for the latter the World Bank “Doing Business Indicators” (Worldbank 2008). Contesting these forms of regulation depends on other factors, such as bargaining power in the issue at hand, which is not equally distributed. It is, for example, well established that international
standards for banking regulation have been set primarily by countries that host major financial centers and could exercise the power of exclusion against those unwilling to abide by them (Simmons 2001). In the long term, such an approach tends to produce what one may want to call an ‘infant regulator syndrome’: The regulated lose the capacity to regulate and to compete with others over regulatory domains. This clearly impedes their regulatory capabilities.

In order to get a better handle on the design of regulatory regimes and their distributional effects from a capabilities perspective, we develop three typologies of regulatory regimes: bargaining, hierarchy, and polycentricism and assess their distributional effects from the vantage point of the regulatory capabilities framework.

If we assume a world of cooperative games in which bargaining power of different actors is equal, bargaining will render pareto efficient outcomes. Parties will enter into transactions only if they are value-maximizing given their respective utility function, which presumably includes the individual capabilities they value most. Viewed in this light, the multiplicity of regulators that is associated with the rise of private regulation is an unequivocal good: It increases the number of regulators, multiplies regulatory regimes and shifts regulation from states as the monopolists of power to a market place of competing regulators. In contrast, in a world characterized by unequal access to the framing of regulatory regimes the picture looks quite different. While regulatory regimes may be multiplying, the regulated frequently face monopolists in narrowly defined regulatory domains. They therefore have little choice but to comply with the rules set by others. Moreover, the inequality between the parties may well increase over time as the regulated have little opportunity to foster their own regulatory skills and therefore will suffer from the infant-regulator syndrome.

In between these two extremes lies a middle ground where regulators and regulated engage in relations that are neither fully cooperative, or horizontal, nor fully prescriptive, or hierarchical. In this world of “polycentric governance” (Black 2008), all relevant stakeholders cooperate in developing solutions for a mutually desirable regulatory outcome, such as product quality or safety, financial market stability, or the like. While not all stakeholders have equal bargaining power, it is typically assumed that they are interdependent in that no stakeholder is capable of independently achieving an optimal regulatory outcome, and each knows this as well. Still, interdependence alone does imply that stakeholders have equal voice in the making of a regulatory regime. Even of polycentric regulatory regime can therefore negative distributional effects on some stakeholders.

The hierarchical model appears least conducive to regulatory capabilities. Regulatory control is asserted at the apex of the hierarchy. If others have little

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4 This obviously plays on Powell’s coining of the field of network organizations as “neither hierarchy nor markets”. See (Powell 1990).
choice but to join a regime, have little say in its making or opportunities to contest it and few realistic exit options, they are condemned to the passive role of the regulated. As Hirschman has pointed out, in organizations stakeholders have essentially three options: Exit, voice and loyalty (Hirschman 1970). In the unequal, hierarchical model the regulated are largely condemned to loyalty.

Clearly, there may be variations in practice. Some hierarchical regimes may offer exit options with the prospect of developing alternative regulatory regimes. Those are less rigid than regimes that constrain choice internally and foreclose exit too. Equally important is the scope of a given regulatory regime relative to the issue being regulated. The more narrowly defined a regulatory regime the less room there is for competition. Clearly, there are advantages to specialization. From a regulatory capabilities approach the critical question is how best to balance the goals of effective regulation with that of regulatory choice. The concept of regulatory capabilities thus helps shed light on the distributional implications of monopoly regulators, whether public or private, and to suggest how even hierarchical systems can be altered so as to give more stakeholders an opportunity to contest them whether by voice or exit.

The bargaining model gives different stakeholders a voice at the ex ante stage – that is, at the time the regulatory regime is negotiated. The parties may agree to renegotiate the regime in the future, or they may give different stakeholders – the regulated and beneficiaries– some veto or participation rights in future alterations to the regime. This ensures that other stakeholders retain a voice in the regime, which should translate into investing in regulatory skills to maintain influence on the regime over time. In the absence of such a renegotiation option, the regulated may lose the capacity to self-regulate and the bargaining model will increasingly resemble the hierarchical model. Thus, from a regulatory capabilities perspective, bargaining at the ex ante stage may not be sufficient to ensure that a regime remains contestable over time. the critical issue is whether different stakeholders have sufficient bargain power to contest a regime and whether mechanisms for future adjustments that ensure contestation by multiple stakeholders are built in or excluded.

Lastly, in the ideal type polycentristic model, the boundaries between regulators and regulated are blurred (Black 2008). No stakeholder has the knowledge or skills to derive the optimal regulatory solutions. They therefore join forces and engage in a process of collaborative problem solving (Sabel and Zeitlin 2008). Regulators have an interest in engaging the regulated in designing regulatory processes and specifying regulatory outcomes, because they are closer to the source of potential problems than they are. They therefore have a comparative advantage in detecting problems and responding to them. The regulated participate in this process in part because it is in their own interest (they may have a genuine interest in producing safe products), and in part because they risk sanctions if they fail to do so, whether in the form of regulatory sanctions or the threat of liability.
Thus, polycentristic models do not entirely dispense with hierarchy; instead they transform it. The shadow of sanctions or the set of standards developed by a regulator frames the regulatory agenda, even if neither prescribes specific regulatory solutions. The challenge this model faces, is to ensure that different stakeholder do indeed pursue similar goals. Joint problem solving makes sense in a competitive environment if the costs of failure are shared by all. However, if externalizing the costs remains an option, some actors may prefer that. A prime example is the area of finance, where regulatory arbitrage is widespread and based on the implicit assumption that the financial system, if not the firm itself, will be rescued. From a regulatory capabilities perspective, polycentrism offers the possibility of inclusive regulation that takes account of all relevant stakeholders. However, not all polycentric regime necessarily do so, but may privilege some stakeholders over others in the problem solving process. It is therefore a question of institutional design to ensure that all those who might be affected by regulatory failure will have a say in the regime.

How much room these different models leave for regulatory capabilities has important implications for individual capabilities as well. As emphasized by Sen and Nussbaum (supra) the realization of individual capabilities is contingent on an enabling environment, i.e. the system of social ordering that determines the relative propensity of each of its members to realize his or her individual capabilities. They are shaped in part by states, even in our age of globalization, and in part by other organizations, including firms, universities, clubs, political parties, and associations. In this sense, regulatory and individual capabilities are mutually dependent on one another. As Sturm has emphasized, citizenship in institutions or organizations is critical for advancing individual capabilities (Sturm 2006). These institutions in turn are members or citizens of larger entities, such as cities, states or transnational networks. Individuals realize important aspects of their capabilities as citizens of these institutions. This, Sturm suggests, influences the behavior of these organizations and how they interact with other entities. However, the reverse may also be true. If regulatory capabilities are denied to entities this affects their aspirations as collective entities; it also affects their willingness or ability to enhance individual capabilities of their citizens.

This has important implications for designing the inquiry into regulatory capabilities. As has been pointed out earlier, such an inquiry cannot start with nation states. States may be regulators but may also belong to the group of the regulated. Moreover, regulation has become transnational and increasingly private. While still reliant on the state in many ways, the rise of transnational private regulation nonetheless implies that the state is no longer the center of all regulatory activities. Neither can the inquiry start with a well-defined group of alternative regulators, such as multinational corporations, or clubs of regulators drawn from different countries, such as IOSCO. What role these organizations play in a given regulatory regime should be part of the inquiry, and should not be predetermined by its design. Rather, the starting point must be a given regulatory regime, understood as one, but by no means the only, way of framing a regulatory domain.
From here, the analysis has to move to the key actors who framed the regime and the other stakeholders affected by it. (We will elaborate on how to identify regulatory regimes and assess their regulatory capabilities further under IV below.)

As pointed out earlier, the framing of a regulatory domain and the establishment of its ground rules institutionalize practices that affect the regulatory capabilities of its different stakeholders. This may entrench existing distributions of regulatory capabilities, or alter them in ways that induce or prevent the enhancement of regulatory capabilities of different stakeholders over time. Regulatory capabilities can therefore be seen both as outcomes of existing regulatory regimes and also as their determinants: Whoever possesses greater regulatory capabilities can frame a given regulatory regime. That regime, however, can be designed in ways that make it more or less likely for other entities to enhance their regulatory capabilities over time. In that sense, regulatory regimes are both the product of pre-existing conditions and determinants of distributional effects.

To summarize, this section has developed the regulatory capabilities approach as a framework for assessing regulatory regimes on a critical dimension that is often neglected in discussions of private or public regulation, namely how a given regime affects the ability of different stakeholders to regulate, not only be regulated. We have suggested that this framework is particularly powerful in the context of transnational regulation. Whereas in polities that are organized democratically it can often be assumed that at some level of abstraction all stakeholders in a given regime are represented, similar assumptions cannot be made in the transnational realm. We have developed this framework against the background of the proliferation of transnational regulation, especially transnational private regulation. While the rise of private actors as regulators may signify a greater multiplicity of regulatory regimes, each with its own regulatory objectives, this does not necessarily mean that these regimes are contestable by those affected by them. Neither does the particular way in which regulatory regimes are established guarantee their contestability. That, however, is critical for the desirability of emergent transnational regulatory regimes from a normative perspective. Only if regulatory capabilities are widely shared are we advancing the agenda of justice beyond the confines of the nation state.

III. The Distributional Dimensions of Power and Wealth

This section explores the distributional dimensions of power and wealth and delineates these concepts from our notion of regulatory capabilities. Just as with regulatory capabilities, wealth and power may be both important determinants of regulatory regimes and the choice of different regulatory models (see supra) and also outcomes of regulatory regimes. While we are mostly interested in how different regulatory regimes will affect the distribution of power and/or wealth over time, we will discuss both dimensions for each concept in turn.
Power

Power is a notoriously difficult concept and has been defined and conceptualized in many different ways. Roughly speaking, the main approaches can be divided into those that equate power with coercion and those that draw a clear distinction between the two and view power primarily as relational (Guzzini 2011). As we will discuss below, the latter has close affinities with our notion of regulatory capabilities.

For those who view power primarily as the ability to coerce others to do what is not in their interests, if necessary by exerting physical force, the primary concern is to make those exercising power accountable to those who might suffer at their hands. In the words of Grant and Keohane, “Accountability functions to expose and sanction two sorts of abuses: the unauthorized or illegitimate exercise of power and decisions that are judged by accountability holders to be unwise or unjust.” (Grant and Keohane 2005, 30).

In this conceptualization regulation appears both as an instrument for the exercise of power and as a means for controlling it. Much of this power debate centers on the nation state and the mechanisms used to hold it accountable to its citizens. The rise of the nation state has been closely associated with the monopolization of coercion in the hands of the state, but equally with the development of a legal system to regulate social affairs in ways that minimize the use of violence and use coercion mostly for enforcing these laws (Hodgson 2009). Given their monopoly over the means of coercion, states always pose the Hobbesian dilemma: A state powerful enough to use its power to enforce the laws and maintain peace is also powerful enough to abuse its power and get away with it. Limiting the abuse of power is therefore the central theme in this literature.

Grant and Keohane distinguish two models of domestic accountability: Direct democracy, which grants constituencies participatory rights; and the delegation of power to representatives who act on behalf of the demos. Direct participation takes place concurrently with the exercise of power, but has to cope with the problem that power wielders tend to resort to popularism to mobilize support, potentially at the expense of the public good. Delegation implies ex post accountability of actions either by the judiciary or by voters. In this case, accountability occurs ex post facto rather than concurrently.

Holding states accountable in the international realm poses rather different problems. Grant and Keohane attribute this primarily to the absence of a global political structure. In fact, as a matter of international law sovereign states can be forced to do things against their interests only in exceptional circumstances. The norm is that they must consent to be bound by treaties, even to judicial review by the International Court of Justice, with the enforcement of the Court’s judgments depending largely on voluntary compliance. While the UN’s Security Council can
unanimously agree to sanction coercion against sovereign states, its powers are limited too. Not only has consensus proved to be difficult to reach; actual enforcement rests largely with the willingness of other states in the international community to commit arms.

Things have grown even more complex with the emergence of new ‘power wielders’ (Grant and Keohane 2005) beyond nation states. As Grant and Keohane recognize, non-state or private actors have proliferated. Even in their nomenclature, which focuses more on public actors, they include not only international organizations such as the UN or the World Bank, but also non-governmental organizations and economic entities. These actors sometimes assume state-like power, e.g. when they impose fiscal discipline or issue laws and regulations, but they also use soft economic or political power to ensure compliance with their preferred policies.

The fact that mechanisms for holding states accountable don’t work in the international realm does not mean that accountability is futile in this context. Rather, it takes new forms. According to Grant and Keohane at least seven forms of accountability can be identified: Hierarchy, supervision, fiscal control, legal accountability, market control, peer pressure and reputational damages (ibid at 36). They involve different power wielders and different accountability holders. Not surprisingly, not all mechanisms of accountability work equally well for all aspiring or actual power wielder (see Table 2 at 37). The hope is that the multiplicity of accountability mechanisms will, in aggregate, provide some check on the abuse of power.

That, however, may or may not be the case. The proposed market accountability for debt and equity instruments, for example, has failed dramatically in the global financial crisis (Turner 2012): As long as share prices kept rising it was not in the interest of shareholders to reign in excessive leverage. And as long as markets remained liquid, creditors were easily deluded into believing that their risks had been diversified away. The real danger is that a competitive regulatory market place with different mechanisms of accountability, which are effective for some but not all power wielders, may reward those who are least susceptible to any mechanism or who do not have an effective accountability holder as a counterpart. In short, the focus on accountability may lead the realists astray: It may prevent them from recognizing emergent constellations of power, but also of governance, that don’t fit traditional models.

These traditional constellations could be more easily divided into two antagonists with fixed predetermined roles: Power wielders and accountability holders. The fact that accountability holders do not exercise power themselves is a function of where they find themselves in world affairs at a given point in time, and there is little they can do about it. Their major concern is not how to yield power, but how to ensure that other power wielders are accountable to them – i.e. that they do not abuse their power and its exercise does not violate basic principles of justice.
From this perspective, our notion of regulatory capabilities as an expression of self-governance is at best a secondary concern. Conversely, from our standpoint the fixation on specific power relations is unsatisfactory in the context of the contemporary reconfiguration of the transnational space. As Grant and Keohane concede, this space is populated by a rather diverse set of actors, and their role as the ultimate power wielders is by no means settled. Competition for power in a relatively open space implies that the efficacy of the instruments of power or of accountability mechanisms is both limited and highly actor-sensitive. It requires a concept of power that is more attuned to the changing roles of different actors who do not perform pre-assigned roles, but are part of a complex set of relations that may render more or less power to different actors over time.

This brings us to the tradition of relational power theories. An early proponent of this approach is Hannah Arendt, who clearly distinguishes power (Macht) from coercion (Gewalt). For her, coercion is a *means* of power, but can never *be* power. Indeed, the use of coercion may undermine power because it can erode power’s legitimacy. Power is a concept that by definition relates to a social group. An individual may exercise coercion: He can hold a crowd at gunpoint. That same individual cannot exercise power, however, but for the willingness of others to comply. Coercion can re-enforce power, but cannot substitute for it, at least not for more than short periods of time.

In the words of Guzzini, in his summary of relational power (2011),

> no analysis of power can be made without knowing the relative importance of conflicting values in the mind of the power recipient, if not also of the supposed power holder. The capacity to sanction and the resources on which the sanctions are based are a part of power analysis, but in themselves are insufficient for an attribution of power because what counts as a sanction in the specific power relation is itself dependent on the specific values in the minds of the people involved.

Once power is viewed as embedded in social relations, then separating how power is exercised, for whose benefit or at whose expense becomes a more complicated task. The exercise of power does not require a confrontation between two or more adversaries – as in the juxtaposition of power wielders and accountability holders. Instead, power is a fluid concept that expresses itself in relations among multiple agents. Neither is the exercise of power confined to forcing others to act contrary to their interests. It also includes the capacity to “effect an action”\(^5\) by various means, including by manipulating the desires of others (as in advertising or, in fact, populism, in Grant and Keohane’s account of direct democracy models of accountability) not only forcing them to do something they know is not in their interest as in conventional power theories.

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\(^5\) Guzzini 2011, quoting Peter Morriss.
Generalizing this point, Foucault has suggested that power cannot be neatly divided into those who exercise power and the mechanisms they use on one hand, and those who seek to hold them accountable and the mechanisms available to them, on the other. Instead “[p]ower must be understood in the first instance as the multiplicity of force relations immanent in the sphere in which they operate and which constitute their own organization” (Foucault 1979, 92-93). In other words, power is latent in all social relations. “To govern, in this sense, is to *structure the possible field of action of others*” (Foucault 1982) (emphasis added). Importantly, Foucault stresses that such exercise of power is limited to those who are free. “Power is exercised only over free subjects, and only insofar as they are free...; slavery is not a power relationship when man is in chains. (In this case it is a question of a physical relationship of constraint).” Arendt would have agreed: This is an example of coercion, not power (see supra).

The relational approach to power has clear affinities to our notion of regulatory capabilities. It is open to different sets of relations among various stakeholders, each seeking in its own right to shape a regulatory space. Moreover, as stated previously, the regulatory capabilities approach promises the ability to regulate, not only to be regulated. At a minimum this presupposes the ability to contest regulations made by others, such as a veto right over future changes in regulatory regimes – i.e. it presupposes some degree of freedom. Controlling a regulatory domain is one way in which latent power can manifest itself. Respect for regulatory capabilities of others signals a more diffuse allocation of power.

The concept of coercive power can help identify the outer bounds of regulatory capabilities. Regulatory regimes that are imposed by some on others while effectively denying any form of self-governance are coercive. By definition, they deny most stakeholders regulatory capabilities. Equally outside the boundaries of regulatory capabilities would be extreme fragmentation of the regulatory space. An absolute guarantee for every stakeholder of a right to self-governance would come at the expense of benefits that result from cooperation in a social domain. This confirms the point made earlier that regulatory capabilities are properties of a collective and while they affect individual capabilities cannot be reduced to them.

The harder cases are obviously those that lie somewhere in the middle between coercion and fragmentation. Importantly, any regulatory regime depends on the ability of groups and communities to organize themselves and determine their regulatory priorities. This is one of the most challenging objectives for policy advisors, and as will further discussed below, goes well beyond the more conventional capacity building approaches pursued by major policy organizations to date.

Within a relational framework of power, asking whether power is primarily a determinant of regulatory regimes with certain distributional effects or an output of such regimes makes little sense. Power is latent in all social relations and can manifest itself in various ways. It is not limited to coercion, but encompasses
persuasion, or the manipulation of desires. Viewed in this light, framing a regulatory domain in itself is the manifestation of power. It does not presuppose existent power structures and where such power relations exist, it does not necessarily follow that they determine a specific regulatory regime. Indeed, every step others take in the framing of the regulatory domain or in shaping the regulatory regime, whether by reserving future veto rights or exercising an exit option, is also a manifestation of power. Clearly, power relations can become less fluid, indeed deeply entrenched. However, in principle at least, any future alteration in the composition of stakeholders or nature of the regime is an opportunity for reconfiguring existing power relations. In that sense, consenting to a given regulatory regime too is an expression of power. It presupposes the ability to say no. Where this possibility is ruled out we are clearly in a world of coercion.

The affinities between a relational concept of powers and the regulatory capabilities approach notwithstanding, we still see some differences between the two. Most importantly, the regulatory capabilities approach is both a descriptive and a normative concept. We seek not only to describe the different ways in which power manifests itself in transnational relations. We also intend to stake out a normative claim, namely that regulatory regimes that deny regulatory capabilities now and in the future are coercive and as such objectionable, even if they render some effective outcomes. Moreover, we hope to influence policy makers by pointing out that the normative appeal of the regulatory capabilities approach can be used to counter the trends towards widespread infant regulatory syndromes based on current power configurations.

**Wealth**

In addition to power, wealth is an oft-mentioned concept in relation to the distributional effects of regulation. Clearly, wealth may determine the kind of regulatory regime that emerges. Economic might can be equated with power both in the realist and the relational concepts of power. It may even be used coercively. It follows that a certain distribution of wealth may result in regulatory regimes that affect the regulatory capabilities of various constituencies.

Conversely, wealth can be conceptualized as an outcome of regulatory regimes. The accumulation of wealth is of great importance for the prosperity of individuals, firms, nations and regions. Policymakers around the world seek to identify the appropriate economic, legal, and regulatory policies to advance prosperity of those living in poverty. Multilateral organizations, such as the World Bank and its regional sister organizations, promote economic growth and development in less developed countries. While material goods may not be the only objective of development, the fact that over one billion people in the world live at the bottom of the poverty scale (Collier 2007) is sufficient reason to search for policies, including regulatory policies that will promote their economic wellbeing. It is therefore meaningful to ask about the relative wealth effects of different regulatory regimes. We agree with Turner
(2012) and others (Stiglitz 2006) that inquiring into the gross wealth effect without considering its distributional effects makes little sense. Greater wealth as such is not a desirable policy goal for countries, entities and individuals at the higher end of the wealth spectrum. What matters is the wealth attainment at the bottom and the overall distribution of wealth.

Quite apart from inquiring into power or regulatory capabilities, we can ask what the wealth effects of different regulatory regimes for global finance have been. An obvious comparison is between the highly publicly coordinated Bretton Woods System of the immediate post-war era (Eichengreen 2008) and the later period, sometimes dubbed Bretton Woods II (Dooley, Folkerts-Landau, and Garber 2004), that was characterized by open markets and floating exchange rates. Specifically, over the past four decades, the regulation of global finance has been transformed. The center of regulation has shifted from public to private and from domestic to transnational; the range of regulatory tools has also been altered from restricting to enabling and the number of actors that perform regulatory functions or are targeted as objects of regulation has increased (Pistor 2011). Finally, this transformation has had disparate wealth effects on different countries, entities, communities and individuals.

This appears to have redistributed wealth between the financial sector and the real economy; between investors, depositors and taxpayers; between small and big players in the financial sector; between domestic and transnational players; and between countries that are the home of transnational financial players and those that are the hosts of their foreign operations. Some of these wealth effects have compounded each other. The concentration of wealth in the financial sector has increased average wealth in countries with substantial financial sectors (even as it has exacerbated the uneven distribution of wealth in those countries); it has also enhanced the wealth of large financial institutions with international presence and decreased the wealth of many smaller financial intermediaries that were unable to compete or relegated to niche positions (Turner 2009). Similar questions could be asked about the wealth effects of other regulatory regimes, such as global supply chains that enforce food safety standards, the certification processes used to ensure fair trade or organically sound production methods, and the like.

The critical question for us is how wealth might relate to regulatory capabilities. Is a more inclusive regulatory regime more or less equitable with regard to its wealth impact? This is clearly an empirical question. There is little systematic comparative evidence available at this stage. While there are studies that have compared varieties of legal systems (Hall and Soskice 2001), countries with different legal origins (La Porta, Lopez-de-Silanes, and Andrei 2008) or the affinity of regulatory regimes with political systems (Levy and Spiller 1994), none to our knowledge has explicitly focused on the distribution of wealth as an outcome variable. Indeed, La Porta et al. explicitly state that their focus has not been on growth but primarily on financial market outcomes (La Porta, Lopez-de-Silanes, and Andrei 2008). In fact, in order to gain insights on the wealth effects of different legal or regulatory regimes
we would first have to assess how they score on a regulatory capabilities index. We will return to these issues in Section V below.

IV. Regulatory Capabilities vs. Capacity Development

We are not the first to argue in favor of inclusive governance approaches that emphasize not only the efficacy of a regulatory regime, but stakeholder participation. Indeed, over the past decade there has been a remarkable reorientation inside key development organizations towards helping countries to take an active role in determining their policy goals and developing requisite regulatory skills and practices. Whereas capacity building was previously understood primarily as helping countries to develop the skills necessary to comply with regulatory demands of existing foreign or transnational regulatory regimes, today there is greater emphasis on ownership throughout the policy work. This has been most explicit at the UNDP, where a shift in terminology from “capacity building” to “capacity development” was meant to usher in a new period of local stakeholdership.

In its 2010 report on ‘Measuring Capacity, the UNDP defines capacity development as “[t]he process through which individuals, organizations and societies obtain, strengthen and maintain the capabilities to set and achieve their own development objectives over time.”6 The UNDP stresses the shift in its approach from supply-driven technical assistance to demand-driven capacity development, an endogenously led change process aimed at giving tangible form to the principle of national ownership. It claims to look beyond individual skills and to focus on training to address broader questions of institutional change, leadership, empowerment and public participation. It recognizes that capacities reside within individuals as well as organizations and that an enabling environment is crucial. It also claims to be adaptable to local conditions and to focus on local ownership of CD strategies.

Key features of the capacity development process as defined by the UNDP include: Its long term nature; its simultaneous linkages to the enabling environment, institutions and individuals; its emphasis on use of country systems; its linkages to broader reforms, such as those in education, wage policies and civil service reform; and its orientation beyond a single focus on training, which addresses broader questions of institutional change, leadership, empowerment and public participation. Specifically, the UNDP sees the CD process as consisting of 5 steps: 1) engaging stakeholders; 2) assessing capacity assets and needs; 3) formulating a capacity development response; 4) implementing a capacity development response; and 5) evaluating capacity development. Monitoring and evaluation of capacity

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6 The Capacity Assessment – Practice Note (October 2008) and the Capacity Development – Practice Note (October 2008) provide an overview of UNDP approach to capacity development.
development is considered essential for national clients to track progresses in enhancing capacities.

The UNDP distinguishes functional from technical capacities. The former are ‘cross-cutting’ capacities that are not associated with one particular regulatory domain. They include the general capacity to formulate, implement and review policies, strategies, programs and projects. In short, they focus on ‘getting things done’. As such, they are closely related to the sector or organization in focus. According to UNDP, the drivers of capacity change at the individual, organizational and enabling environment levels are institutional arrangements, leadership, knowledge and accountability.

In short, the UN’s approach to capacity development is primarily effective and accountable governance. It promotes the capacity to be regulated, but does not at its core advance a self-governing agenda of regulating. It marries efficiency and accountability but lacks a perspective on the distributional effects of regulation within regulatory domains. Lastly, in the context of capacity development the state remains the primary unit of analysis. Individuals and organizations matter, but primarily as part of an integrated, state-centered governance regime.

As has been noted, private actors increasingly shape regulatory regimes, especially in the transnational realm. While they frequently piggy-back on state institutions, especially for enforcement, an effective response to the shifting power relations requires more than improving state capacity. The latter may simply become an instrument for the implementation of transnational private regulatory regimes. From the perspective of the regulatory capabilities approach developed in this paper, it requires an ability to define regulatory domains, to identify actors, both private and public, who are best situated to shape the domain and to build coalitions with other stakeholders in order to respond to the demands and advances of other actors, whether public or private, who seek to control a given regulatory space.

Other policy organizations have also pronounced a commitment to local ownership and stakeholder participation. These pronouncements, however, are even more general than that of the UNDP and lose traction when applied to specific policy domains. Thus, the World Bank explicitly rejects most capacity development definitions as too broad for policy purposes. It nonetheless defines capacity development as a locally driven process of learning by leaders, coalitions and other agents of change that brings about changes in sociopolitical, policy-related and organizational factors to enhance local ownership and effectiveness of efforts to achieve a development goal (WB 2009 p. 2).

Closer scrutiny, however, reveals that the World Bank views capacity development primarily as a condition for pursuing the development goals it has specified. The

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7 This is not to say that the UN has not developed analytical approaches to deal with the process of globalization. See especially the work on global public goods by Kaul et al. [ADD]
conceptual move is to shift attention from the principle of self-determination to supposedly objective ‘capacity factors’ and from there to indicators that measure capacity output rather than input. Capacity factors are defined as (1) the conduciveness of the sociopolitical environment in determining priorities among development goals identified by the government, private sector and civil society; (2) the efficiency of policy instruments, or the formal mechanisms to be used to guide stakeholder action towards achievement of the development goal (those formal mechanisms include administrative rules, laws, regulations and standards); and (3) the effectiveness of organizational arrangements, or the systems, rules of action, processes, personnel and other resources that government and non-government stakeholders bring together to achieve development goals (WB 2009, p. 11). These capacity factors can be enhanced by incorporating development goals. They are measurable via standard indicators, such as ‘good governance’ or the ‘ease of doing business’ indices developed by the World Bank. These capacity indicators may be customized to particular situations but should always remain measurable.

This completes the shift from a normative agenda of self-governance to performance measures based on pre-determined indicators, which by definition are not contestable. In the tradition of the World Bank, these are country-level indicators based on best practice standards derived from developing countries. This ignores the changing landscape of transnational regulation and the shifting power relations it entails. It also undermines the commitment to local preferences and local choice.

The OECD’s approach takes a middle ground between the UN and the World Bank. In a 2006 report that reviews the OECD’s approach to capacity development (OECD 2006), the organization defines capacity as the ability of people, organizations and society as a whole to manage their affairs successfully; and capacity development as the process by which people, organizations and society as a whole create, strengthen and maintain their capacity over time. When specifying the details of the approach, however, the OECD reveals that it is not fundamentally different from the World Bank. Ultimately, capacity is about reaching goals at the country level that have been defined by international development organizations such as the UN, the World Bank or the OECD:

The relationship between capacity and performance in human affairs may be illustrated by analogy with the motor car. We are careful to maintain the car’s engine, chassis, brakes, tyres, etc. – its capacity – because we value the safe and reliable transportation – the performance – that it provides. Development co-operation agencies are ultimately interested in the factors that make possible a strong performance in relation to developmental goals and the MDGs. This requires a clear understanding of the various determinants of that performance.

There may be little disagreement about some core development goals, such as the MDG. However, when it comes to defining the goals in more specific policy areas, and to determine the allocation of costs and benefits for specific regulatory regimes
associated with them, there is little reason to assume that a well-oiled car engine is the best strategy for advancing the interests of all relevant stakeholders.

To summarize, there is undoubtedly some affinity between the regulatory capabilities approach developed in this paper and the notion of capacity development advanced by organizations such as the UNDP, the World Bank and the OECD. All agree on the importance of stake holding or ownership of institutional arrangements. Yet, the goals and the focus differ. As we have seen, for the multilateral development organizations capacity development is in the end the means by which they hope to achieve goals that have already been established. The fact that their definition of capacity development supports stakeholder ownership of both goals and means of development projects should not distract from the fact that there is an implicit assumption that there is, in fact, no disagreement about development goals, nor that they could possibly have distributional consequences. And lastly, they continue to emphasize states and state institutions as the primary agents of regulation and governance, notwithstanding the reordering of the transnational regulatory space between public and private, domestic and international players.

The regulatory capabilities approach pursues a different agenda. It thus shifts the focus of attention from the conventional lens of governance by and through states to emergent forms of governance in our globalized world. And it emphasizes that regulation is not only about effectiveness, but also about self-governance and the creation of an environment that is conducive to the realization of individual capabilities by all.

V. Mapping Regulatory Regimes and the Impact on Regulatory Capabilities

In this section, we seek take our concept of regulatory capabilities to the real world. It can be most usefully applied in two ways: First, to map existing regulatory regimes, identify their key stakeholders and specify the indicators for assessing the scope of regulatory capabilities they possess within that regime. And second, to suggest ways in which regulatory regimes can be framed or altered to foster regulatory capabilities of multiple stakeholders.

Mapping Regulatory Regimes and Regulatory Capabilities

We begin by mapping issue areas, such as financial stability, food safety, or environmental soundness. Each of these issue areas is sufficiently broad to allow for more than one regulatory regime. Indeed, this is exactly what we observe. It may come to no one’s surprise that we have multiple national regulatory regimes. But even within nation states we frequently observe the multiplication or balkanization of issues into multiple regulatory domains, each controlled by different stakeholders. Witness the inability of the US to streamline the framework of financial regulation in the aftermath of the global financial crisis, which has left the
byzantine structure of multiple regulators with partly overlapping jurisdictions largely in tact (Acharya et al. 2011).

The same applies to transnational regulation. In the area of finance we have replicated the functional division found inside many domestic systems by entities (banks vs. non-banks) or financial instruments (securities vs. commodities) and created transnational regulatory coordinators, such as the Banking Supervisory Committee and the Bank for International Settlement, the International Organization of Securities Committees (IOSCO), the International Accounting Standards Board and the like. In addition, there are other entities, such as stock and commodities exchanges, private trading platforms, each with their own private regulatory regimes. While some functional division of labor may be advisable to ensure effective governance of a complex financial system, the current division of the regulatory space in finance depicts a deeply contested field in which control over regulatory outcomes is critical.

It follows that a specific regulatory regime is defined by whoever frames and/or controls the choices that can be made. A full determination of the exercise of control will require more than a merely formal analysis of rules, regulations, membership agreements or contracts that circumscribe a regulatory regime. Still, even the formal arrangements give some clues about control structures and the scope of other-regarding concerns. They reveal whether stakeholders other than the regulators themselves can become members and on what terms. They also indicate formal veto or approval rights.

The major contribution of the regulatory capabilities approach is to inquire whether all stakeholders that are implicated by a regulatory regime have a direct or indirect say in its design, its modification or have a valid exit option. In this context, direct say means that they can approve or reject a regime and/or specific features of it. An indirect voice stands for the proposition that even if, say, not every taxpayer who will have to finance a bail out has a voice in the design of model contracts for derivatives, an effort led by the International Association of Swaps and Derivatives Dealers (ISDA), for example, another agent that effectively represents these taxpayers, i.e. state regulators, does. A valid exit option requires not only the existence such an option, but the ability to avoid economic extinction should one exercise it.

This analysis is sufficiently general to be applied to different regulatory issues. To illustrate, we have developed a simple analytical flow chart (see Figure 1 below). Its purpose is to help locate specific regulatory regimes within a broader regulatory field; to identify their key properties and to offer a road map for determining which stakeholders are best situated to realize their regulatory capabilities. Importantly, the flow chart does not assume the existence of specific entities (states, associations, communities) or means of regulation (public or private law). It is pitched at a sufficiently abstract level to encompass a range of actors, regulatory fields and regulatory tools.
Creating a map of different regulatory regimes and their impact on regulatory capabilities should allow us to answer some pressing questions that have hardly been addressed in ongoing regulatory debates:

- Who benefits and who loses from the contest over the transnational space in terms of regulatory and individual capabilities?
- What is the distribution of winners and losers in terms of geography (North vs. South), private and public, big and small, rich and poor?
- How does the distribution of regulatory capabilities today affect regulatory capabilities in the future?
- Through what mechanisms can those who are currently crowded out from the framing and shaping of regulatory domains improve their position and become regulators in the future?

_Institutional Design_
The flow chart can also be used to identify where intervention may be most needed or effective in order to ensure that critical stakeholders have voice or exit rights in a given regime. That analysis needs to start from stakeholders in one or more existing regulatory regimes. It inquires whether they have voice or exit rights in those regimes and if not, how their regulatory capabilities might be better served. From there the analysis moves upwards towards the regulatory domain, the agents that control it and the broader field of regulation. At each stage, the inquiry should probe into what aspects of the regime are binding, and what aspects leave options for alternative design that would take account of stakeholder interests.

For illustration, consider local farmers who seek access to export markets for their produce. They face regulatory restrictions set by public or private agents in their home countries or abroad. Whether or not they or their representative has any say in the design of these regulatory regimes and the allocation of the cost of compliance or liability in case it fails, determines their regulatory capabilities within existent regimes. A further question would be, whether they could create alternative regulation that better reflects their concerns and interests. Even if foreign public agents, such as the FDA, set food safety standards that are not amenable to the input of farmers in rural Mexico, there is usually room for more than one regime to implement these standards. A local cooperative or domestic public regulatory may allocate compliance costs quite differently than private importers. Obtaining direct accreditation with the FDA may therefore be superior to complying with a single private regime. At the very least, it would introduce competition in the implementation and compliance process.

A full exposition as to how the regulatory capabilities approach might be used to (re-)design regulatory regimes would require much greater specificity than is possible in the context of a conceptual paper such as this one. We will pursue this agenda in future writings.

VI. Concluding Comments

This paper has introduced the concept of regulatory capabilities, explained its value as a normative benchmark for assessing the ongoing contest over the transnational regulatory space and distinguished it from other distributional dimensions of regulation, such as power and wealth on the one hand and semantically similar concepts in the development literature, such as capacity development, on the other.

Its goal is to refocus attention from the efficacy of regulation – as important as that objective clearly is – to the impact of regulatory regimes on collective and individual self-determination. If, as Sen, Nussbaum and others have emphasized, development is ultimately about freedom, freedom must figure into the design not only of national, but also of transnational regulation, of individuals as well as collectives. In the past we have relied primarily upon the political governance of nation states to
accomplish this task. In a world where states and their agents are no longer the only or primary regulators yet we do not have a unified global political system, we need a different framework. We propose that the regulatory capabilities approach offers a way to ensure participation in the absence of political structure. It does so by offering a diagnostic tool kit for locating power relations and using indicators, such as voice and effective exit rights, to assess them and develop strategies that can help advance regulatory capabilities while still achieving critical regulatory objectives such as food safety or financial stability.

What may be necessary is a reconfiguration of regulatory regimes in many issue areas. This does not necessarily require a frontal attack on existing ones. Instead, we may want to take a page out of the rulebook of the strategies employed by those who have gained control over critical regulatory domains in the transnational realm. That would suggest that a more effective strategy than confrontation is the establishment of new, competing domains. The critical design question is how to attract enough defectors from existing domains while ensuring broad-based voice and exit rights to pose a viable competitive threat.

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