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FOUNDATIONS OF EFFICIENT SUPERVISION OVER THE GLOBAL FINANCE MARKET

Summary: The extent of the latest financial crises provokes reflection on many aspects of the functioning of modern financial markets. In the scientific discourse, the notion of institutional conditions in a broad sense as a source of the current financial crisis is prominently featured. This article perfectly fits in the deliberation on this subject. The author attempts to explain the problem of the supervision structure over the global financial market utilizing the findings of the new institutional economics.

Key words: functions of states on the market, global financial market, oversight of financial market, cooperation, coordination, institutions.

1. Introduction

The extent of the latest financial crisis forces us to reflect on many aspects of the functioning of modern financial markets. One particular area which compels the interest from the theory of economics is the issue of effective institutional governance on the financial market. The crisis has exposed the negative consequences of ineffective supervision over the financial market, in particular, in a global extent. Incapacity problem with regards to supervision in some areas of the global financial market has led to a financial crisis and its destructive acceleration.

The current financial crisis started several years ago and since then numerous studies and analyses dedicated to it have been prepared, but it has not been fully recognized and diagnosed yet. Although there are different opinions on its essence, causes, and suitable counter measures. This article is a continuation of research on that subject. The author deals with the aspect of construction of supervision over the global financial market. In particular, the author attempts to identify the character and reasons of supervision incapacity in that area and show the most adequate counter measures considering the scientific achievements of the new institutional economics.

2. Transitional form of the supranational system of law making and supervision over the global financial market

Modern economics and particularly the new institutional economics pay much attention to the issue of market principles and organization. Description and explanation of market principles in the new institutional economics is different to the ones in neoclassical economics. For the representatives of this branch of economics, markets in economic reality are not those with perfect market assumptions and coordination of individual choices and actions of business enterprises in a mechanistic way. Consequently, economy practice markets, according to the representatives of this branch of economics, cannot function without institutional limitations of actions, which may be of a different nature. At this level of state, institutions are created which become parts of the market's legal system. This type of market institutionalization is defined by O.E. Williamson as jurisdictional governance. The second level is described by Williamson as a non-obligatory level and recognizes that institutions creating it are not connected with legal responsibility but moral obligation of the market participants to keep the promise (moral principles) [Williamson 2000].

For the representatives of the new institutional economics, the main guarantor of governance on the financial market is the state that performs two main functions: imposes framework rules of conduct on the market and compels the observance of the rules [Williamson 2000; Buchanan 1975]. What is important is that the representatives of this branch of economics see that the role of the state in shaping the order on the financial market must depend on a degree of integration of the domestic economy with the global economy. According to D. Rodrick, a perfectly integrated world economy enforces giving up the nation state in favour of global federalism. In the global federalism model, the national governments do not have to disappear, but their authorization to enforce framework rules and their execution are limited by supranational legislative, executive, and legal authorities – some kind of a global state and government. The global state would perform functions of a nation state, but those functions would be performed in a global extent of the financial market. It can be best described by Rodrick's words:"the state's and world government's concern would be the world market" [Rodrick 2000].

On the other hand, Rodrick realizes that the global state model as a way of managing the world economy will not be accepted any time soon. Nation states would have to accept that their sovereignty would be significantly limited in the field of performing functions for the centralized world government. This is why Rodrick concedes that an alternative for global political federalism would be a transitional form of a supranational legislature system and supervision over the global financial market. Within the framework of this system of imposing rules and their execution, based on nation states, in the course of cooperation and coordination, institutional solutions would be developed (international standards), which would be transferred and harmonized at the level of domestic legal systems and supervision concepts for the financial market [Rodrick 2008].

Alas, such a supranational structure of law-making and supervision over the global financial market has one fundamental shortcoming. It mainly relates to difficulties connected with the execution of framed rules for the global financial market at the level of nation states. Only at the level of nation states and no other part of this supranational structure are formal rights for execution of legislated legal rules guaranteed. Without a clear execution system, the formulation of legal rules is just a wishful action [Maddison 2001; Szymański 2009]. It is hard to disagree with such a standpoint. This issue was also raised by Thomas Hobbes, the creator of the so-called social contract, who famously said that "covenants, without the sword, are but words and of no strength to secure a man at all" [Hobbes 1954].

Another important issue connected with the established and enforced governance on the supranational markets, particularly the financial market, has been raised by J.H. Dunning. According to him, there is a new political polycentric system forming where an individual country will become one of the parts of the complex system of linked and competing entities authorized for managing the economy and politics. There are two massive problems arising: sovereignty of nation states and supranational coordination in the field of institutional governance without prejudice to interests of individual countries [Dunning 1997].

All the aforementioned aspects related to the enforcement and the execution of institutional governance over the global financial market enforce consideration of the issue regarding the cooperation and coordination of nation states as one field of collective actions which is a domain of interest for the new institutional economics.

3. Foundations of the cooperation and coordination of the states' actions for creating institutional governance on the market

The issue of cooperation and coordination is a key problem for collective actions in economic, social, and political matters. Particularly important is the research on the cooperation and coordination in the economy and its branches as well as in state and political structures. Cooperation is just a mutual desire to help which constitutes part of coordination. Coordination is the sequencing of actions in the realization of common objectives, supported by the coordinating function and formally and informally established relations [Friedman (ed.) 1993].

In the theory of economics and mainly in the new institutional economics, it is assumed that cooperation is started between rational egoists interested in mutual benefit. Rational egoists recognize that cooperation will help them to gain benefits at a lower cost than through individual actions. It must be added that rational egoists taken into account here are egoists who, after having calculated all benefits and costs, decide to cooperate. This feature distinguishes from "egoists by nature" who do not accept that gaining individual benefit might require cooperation with other people [Hobbes 1954]. The notion of individual interest might encourage breaking the cooperation. Economic view of the cooperation issue through rational aspirations of individuals to gain benefits has broken the monopoly of sociology for explaining the cooperation by altruism, socialization, and correlation of individual interests.

The state can be classified as a rational egoist because, according to the standpoint of the public choice theory, the state is not "one" – it is rather the behaviours of individual politicians and public officials, who just like other business entities to be focused on maximizing their utilitarian functions. They are ready to take mutual actions only when estimated marginal benefits of those actions exceed the estimated marginal costs. Their rationality is at the same time limited, because they do not have a monopoly for information and their control over actions of other entities is limited.

Cooperation of rational egoists-governors can take place in proper conditions (climate) only. Much attention is paid to the possibility of implementation of the reciprocity rule. Reciprocity encourages cooperation, because, as a result, the entity (game partner) gains benefits from the other part, which are as valuable as those it gives in return. The consolidation of this rule provides a fair distribution of benefits between rational partners and reduces the risk of hostile actions between the partners. According to M. Taylor, the reciprocity rule should be expanded with two additional conditions of cooperation: multilateral and direct relations between the partners and common values and beliefs. M. Olson recognizes positive and negative stimuli (encouragements and punishments) as encouragements for consolidating the cooperation [O'Hara 2004]. J. Buchanan and G. Tullock point to the political involvement rule as a prerequisite for the cooperation in the field of politics [Buchanan, Tullock 1962; Truman 1993]. What is important is that the representatives of the public choice theory (mainly Buchanan, Tullock, Olson, Benson) claim that the cooperation between rational and egoistic governors depends on the number of partners to the agreement as well as the efficiency of implemented detection mechanisms for low-operational actions and their individual orientation for achieved benefits. In smaller "environments" of cooperation where parties observe each other and their relations are frequent and direct, the probability of breaking off and avoiding cooperation is lower when compared to a numerous number of partners. The community of objectives, resources and values is another meaningful factor.

D.C. North pays much attention to the institution as coordination mechanism of common actions aiming at providing order on the market. He thinks that "the invisible hand" will not make the coordination problem disappear. It can happen only when the costs of coordination are zero, the negotiation process would be transparent and the parties would trust each other. That is why, *sine qua non* conditions of successful cooperation and coordination of actions aiming at ordering the market are institutional limitations created by the people [North 2007].

A similar approach to this problem is represented by M. Aoki, who pays attention to the fact that cooperation becomes more difficult if there are more actors (countries), their objectives and resources are different and the "free-rider" issue becomes more noticeable. Actions of nation states aim at reaching the designated objectives are connected with the costs, including the costs of coordination. Each state has a vested interest in concealing the benefits resulting from common actions in order to decrease its input in the costs of reaching the desired results. In smaller "political environments" where everybody knows each other and the cooperation is close (matter of trust), there is a chance that the coordination will be easier and the desired results will be achieved at lower costs. The coordination mechanism can be a cohesive and complimentary set of institutions [Aoki, Takizawa 2002]. In contrast to institutionalists from other sciences (sociology, politics, philosophy), he acknowledges that constructed institutional solutions are more important in this respect than social norms and social and political involvement networks. In addition, M. Aoki claims that coordination as a form of regulated actions of nation states in the scope of essential aspects of functioning of the world economy, must have its logic which means taking five key issues into consideration. The issues are: "political environment", in which the cooperation takes place, determined objectives of cooperation, stages of the cooperation process, identified tasks and partners' (countries) resources, and coordination mechanisms. The provision of these issues is important because, as it shows referring to findings of the representatives of the social conflicts theory (R. Dahrendorf, I. Coser, or J.H. Turner), unbalanced input of committed resources (incurred costs) and the awareness of impairment of own interests might be the ground for conflicts and the loss of cooperation [Aoki 2001].

4. Architecture of supervision over the global financial market – diagnosis of problems and desired modifications

In the times when financial markets were not subject to integration, supervision over this area of business activities was performed by an unintengrated nation state. Depending on the chosen type in an individual country, there was an integrated supervision (cross-sector) or a sector supervision (specialized).

Progressive liberalization and deregulation of cross-over capital flows made it necessary to open national financial markets, which resulted in the cooperation between the state nations performed within the framework of partner agreements between supervision authorities of the host country and the guest country. Within the regional structures, supervision is based on state countries integrated regionally. The results of such practices can be best illustrated from the perspective of the regional structure of economic integration such as the European Union. The domestic country supervision rule implemented in the EU means that supervisory activities are delegated to the supervision authority of a domestic country. The supervision of a guest country is limited to a general control of legality of its actions and confined power to take imperative actions. As long-term research shows, in that type of supervision there were frequent conflicts between the supervision authorities of the host and the guest countries [Jurkowska-Zeidler 2007].

Such practices became a main stimulus to change the architecture of supervision over the financial market in the EU. In late 2010, the European Parliament brought into existence two bodies important from the point of view of the integrated supervision over the European financial market. The new concept of supervision abandons the notion of sector supervision for integrated supervision, but, what is more important, it introduces comprehensive supervision over the financial market (macroprudential supervision and microeconomic-market supervision. Macroprudential supervision has been delegated to The European Systemic Risk Board while microeconomic-market supervision has become the responsibility of the European System of Financial Supervision. The European market supervisor is superior to domestic supervisors. If a domestic supervisor does not perform its role properly, the European supervisor may take enforcement measures in order to restore the institutional governance. In addition, it acts as an arbitrator in the case of conflicts between the domestic and the host country supervisory authorities.

Internalization of capital flows exceeded the regional scale a long time ago. The financial crisis which spread across the globe is an irrefutable argument for destabilization, which resulted from the globalization of capital flows.

The first attempts at transnational cooperation in the field of regulation and supervision started in the late 1970s. At that time, the Basel Committee on Banking Supervision under the auspices of the Bank for International Settlements was founded. It became a milestone for the supranational cooperation in the field of banking supervision.

Other supranational forms of cooperation in the field of regulation and supervision were set up in the mid 1990s as there were frequent threats of destabilization also in other areas of the global financial market. These initiatives were the Financial Stability Forum and the Committee on the Global Financial System. The former is nowadays the basis of the supranational structure in the field of regulation and supervision over the global financial market. The members of the Financial Stability Forum are representatives of the most industrialized countries and their central banks as well as domestic and international supervisory authorities and the most important international financial organizations (the Basel Committee on Banking Supervision, International Monetary Fund, the World Bank, Bank for International Settlements, Organization for Economic Cooperation and Development) as well as representatives of some emerging-markets countries.

The Financial Stability Forum has an information-advisory capacity. In the course of discussion within the framework of the Board, an agreement is being worked out concerning the main assumptions for regulation and the architecture of supervision over the global financial market. Work aimed at achieving the unified regulations and supervision structures is progressing with difficulty. According to J. Eatwell, The Financial Stability Forum could become a transnational body entrusted with a wide scope of power including: authorization, supervision, management, execution, and politics. It would thus require that the national governments become its agendas. Today, it seems unrealistic that, for political reasons, the national countries would agree to transfer their powers in the field of regulation and supervision to The Financial Stability Forum [Liberska (ed.) 2002].

It is not the country that stipulates the conditions for the international financial capital to follow – it is just the opposite – the financial capital imposes the conditions that the country must adhere to [Szymański 2009]. Nowadays, the country is "minimal" not because of doctrinal assumptions but due to its limited power and authority to impose market rules on international capital. In the course of economic globalization, the country's position in the field of regulation and supervision over the financial market has deteriorated while all the efforts to create even a substitute global power have been unsuccessful. The Financial Stability Forum as a supranational structure in the field of rules and supervision has not been equipped with any legal instruments (formal laws) to enforce formulated recommendations at the level of national countries. According to research carried out by the World Bank experts from the G-77 group, over 30 countries did not observe The Financial Stability Forum's recommendations [Żakowski 2009]. It shows how difficult it is to unify rules and supervision structures over the global financial market.

The most important thing is to, within the framework of The Financial Stability Forum, designate a coordinator who will be responsible for enforcing rules in the supranational dimension and simultaneously ensure the observance of such rules. The Financial Stability Forum does not have any efficient solutions in the field of enforcement of formulated institutional limitations. This is clearly an institutional drawback of this supranational structure. The more abstract the enforcement system is, the more wishful the system becomes. This issue has been raised before, when referring to the ideas of the creator of the social deal – T. Hobbes, who claimed that the covenants without a sword would not secure a man. The cooperation within The Financial Stability Forum in not easy because the nation states do not have the knowledge if this political game will be continued with their presence. Since the inception of this supranational body, there have been various line-ups of countries taking part in the work. In such circumstances, the nation states are not willing to implement the cooperation strategy and build the social capital (trust) for future cooperation [Stiglitz 2002].

In addition, a relatively large number of countries taking part in the political games limit the opportunity of implementation of the partner obligations rule (the reciprocity rule). In such a numerous group of countries, there is a high risk of uncooperative actions (free riding). Within the framework of the Board, no mechanisms determining the involvement of individual political partners into the works have been created so far. No adequate stimuli for consolidation and facilitation of cooperation between political partners have been secured.

One cannot ignore another aspect defining the capabilities of a supranational forum to reform legal rules and supervision over the global financial market. This is a limited ability of nation states' representatives to create subjective mental model for identifying the reality and necessary changes. Consequently, politicians might not be able to define the prevailing ideology based on the values important in the social dimension. This has been aptly expressed by French historian and political scientist E. Todd: "In this crisis mess, the people in power are totally lost. ...when the free market ideology conquered the minds of politicians around the world and when it became the domineering ideology, the system collapsed. And it is extremely dangerous: politicians paralyzed by the domineering ideology are not able to reflect on new solutions" [*Żyjemy w przegranym*… 2009].

5. Conclusions

In the field of regulation and supervision over the global financial market, the arrangement that has been created uses the elements of logic taken from the governance based on a nation state and the elements of logic resulting from the opportunity to act in the supranational sphere, which is virtually not controlled and coordinated. Above all, this arrangement lacks an institutional basis for the coordination related to the enforcement of compromise between conflicting interests of nation states.

Because the notion of creating a global country with a global government seems unreal, the transnational coordination formula must be improved. Agreements within the framework of the Board, taking into consideration the number of countries and their different interests, are not going to be easy. A stronger basis for agreement would appear if the regional group of countries entered into such agreements instead of individual countries. A smaller number of the regional groups of countries would lead to agreement more efficiently and at lower costs. It would be easier to use the reciprocity rule and restrain them from the free-rider approach. In addition, the power and influences of individual partners could be balanced and would put off the partners from focusing on particular interests at the expense of other parties to the agreement.

Within the framework of the supranational coordination structure, there should be a special body performing duties of the main coordinator in the field of enforcing boundary limitations and their observance. This body would develop the concept of the transnational coordination system and designate institutional solutions, which acting as stimuli, would establish and expand the common ground for mutual action at the transnational level in order to ensure a uniform and efficient supervision over the global financial market.

Thus, it can be said, to sum up the deliberations, that the current structure of the supranational coordination in the field of supervision over the global market is not efficient. The key conditions necessary for starting and establishing the cooperation, as defined by the theory of economics and in particular by the new institutional economics, have not been met. Using the contribution of the theory of economics in political practice at the transnational level may lead to creating a foundation for successful cooperation and coordination in the field of developing rules and structures of supervision over the global capital market. The idea of a multi-phase implementation of the transnational coordination related to reformation of rules and supervision over the global financial market based on the regional institutional governance logic should be particularly supported.

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PODSTAWY SKUTECZNEGO NADZORU NAD GLOBALNYM RYNKIEM FINANSOWYM

Streszczenie: Skala ostatniego kryzysu finansowego skłania do refleksji nad wieloma aspektami funkcjonowania współczesnych rynków finansowych. W dyskusji naukowej jest wyraźnie eksponowany wątek szeroko rozumianych uwarunkowań instytucjonalnych, jako źródła obecnego kryzysu finansowego. Artykuł ten wpisuje się doskonale w rozważania w tym względzie. Jego autorka podjęła próbę wyjaśnienia problemu konstrukcji nadzoru nad globalnym rynkiem finansowym przy wykorzystaniu dorobku głównie nowej ekonomii instytucjonalnej.

Słowa kluczowe: funkcje państwa na rynku, globalny rynek finansowy, nadzór nad rynkiem finansowym, współpraca, koordynacja, instytucje.