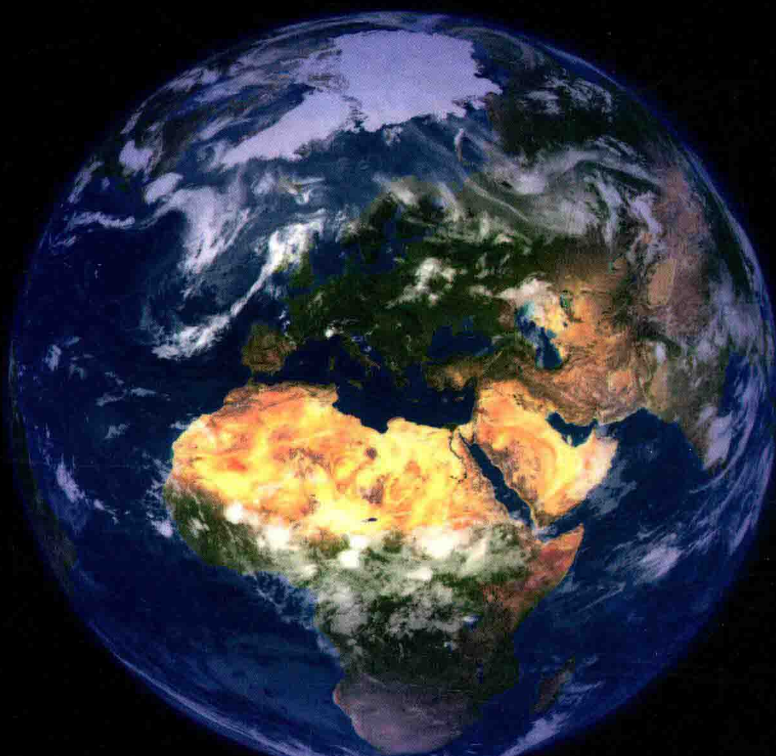
TRANSNATIONAL COOPERATION



AN ISSUE-BASED APPROACH

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Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
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Published in the United States of America by
Oxford University Press
198 Madison Avenue, New York, NY 10016,
United States of America

Cataloging-in-Publication data is on file at the Library of Congress

9780199398607 (hbk.)
9780199398614 (pbk.)

9 8 7 6 5 4 3 2

Printed in the United States of America on acid-free paper

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To Anne Dutia and Jeannie Murdock

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PREFACE

Transnational, regional, and global challenges abound in today's interdependent world and require cooperation among countries. In some instances, multiple countries must jointly address a contingency (for example, the spread of an agriculture pest); in other cases, countries in the same geographical region must act in concert to alleviate a concern (for example, acid rain); and in still other scenarios, all countries of the world must work together to achieve an outcome (for example, curbing climate change). The need for transnational cooperation among countries will grow in importance as globalization increases cross-border exchanges of a desirable and undesirable nature. The exchange of knowledge and culture is desirable, while the exchange of pollutants or financial instability is undesirable. Population growth also places stresses on the planet that make one country's problems adversely impact the welfare of other countries, thereby increasing the need for transnational cooperation. For instance, deforested hillsides in one country may result in flooding or climate change in a neighboring country. Civil conflict in one country may create refugee flows that affect neighboring countries. With huge daily flows of financial capital, countries' economies and fortunes are closely interdependent.

Transnational cooperation or the action by two or more sovereign countries to promote their common good has seen both successes and failures in recent decades. Thus far, actions to check climate change, resulting from atmospheric accumulation of greenhouse gases, have been a cooperation failure despite some hopeful signs at the December 2014 meeting of the Conference of Parties to the Kyoto Protocol in Lima, Peru. The eradication of smallpox in 1979 and the near eradication of polio are clear transnational cooperation successes. The allocation of geostationary orbital slots and electromagnetic spectrum frequencies to satellites is another transnational cooperation success. Other such successes include deployment of tsunami early-warning systems, regulation of air corridors for commercial flights, a universal set of weights and measures, creation of the United Nations, deployment of effective peacekeeping operations, and the reduction in ozone-layer-depleting substances. So the big question for this book is what factors promote or inhibit transnational cooperation. In those cases where the required cooperation is not forthcoming, we need to discern what actions or institutions can overcome barriers and further transnational cooperation.

To pursue our study of transnational cooperation, we rely, in part, on elementary game theory, bolstered by concepts from economics, political science, and political economy. We assume no prior knowledge of game theory; all game-theoretic concepts, tools, and analyses are explained in detail for the uninitiated reader. These concepts are reinforced with myriad examples and repeated throughout the book. Transnational cooperation requires strategic interaction among countries and other key agents (for example, multilateral institutions, multinational firms, nongovernmental organizations, and public-private partnerships) that is best captured by the tools of rational interactive choice, or game theory. This rational interactive choice may or may not result in desirable outcomes. The celebrated, and overused, Prisoners' Dilemma leads to very undesirable outcomes, but other game forms are often associated with better outcomes. Economic concepts, such as markets, market failures, public goods, the commons, and externalities, also play an important role in our analysis. We are very interested in elucidating the role and importance of institutions. Such institutions can fundamentally affect the success of transnational cooperation and have assumed novel forms in the current era of globalization.

The book commences with four chapters that lay the foundation for the analysis. This is followed by a rich set of issue-based chapters that consider foreign assistance, global health, sovereignty, leadership, international trade, global finance, civil wars, terrorism, drug trafficking, money laundering, rogue states, nuclear proliferation, climate change, ozone-shield depletion, and other topics. We know of no other book that addresses such a rich set of topics of current importance with an elementary but firm theoretical basis.

This book has a number of other unique features. First, the book's authors include a political scientist and an economist, both of whom possess a firm grounding in both disciplines. Second, the book relies on paired comparisons to clarify the subtleties of transnational collective action. These comparisons allow us to ask a host of questions. For example, why has the world been so successful at curbing ozone shield depletion but so unsuccessful at reducing climate change? This is the case even though both issues involve global public goods with similar attributes. Another question concerns whether failed states pose a greater security threat than rogue states. Yet another question involves why the prognosis for cooperation differs between sulfur-based acid rain and nitrogen-based acid rain. Understanding these and many other paired comparisons in this book will allow the reader to learn that simple maxims—for example, fewer participants promote successful collective action—do not necessarily hold and why. Third, our book focuses on collective action and cooperation at three levels of aggregation: the global, regional, and transnational levels. Most books either focus on global or regional cooperation without comparing and contrasting these two types of collaborations. Much can be acquired by distinguishing between global and regional cooperation and the requisite institutions involved at these two levels of aggregation. Fourth, the book concerns both economic and political issues. Sovereignty and leadership would not be considered in an economic treatise of transnational cooperation, while international trade and market failures are unlikely to be examined in a political science analysis of transnational cooperation. We intend this book to be a true treatise in political economy by treating both political and economic concerns with adequate care, skill, and insight.

The current book is much more than an updating of Sandler's *Global Collective Action* (Cambridge University Press, 2004). Much has happened since 2004 to the exigencies confronting the world. This means that many topics not found in the earlier book (for example, sovereignty, leadership, failed states, financial crises, drug trafficking, money laundering, nuclear proliferation, and others) are included in the current book. Moreover, many topics in *Global Collective Action* are not in *Transnational Cooperation*. By including a political scientist as an author, the current book has more appeal to readers interested in international relations and public policy, while retaining its appeal to readers in economics. Any chapters in *Transnational Cooperation* that partially overlap with topics in the earlier book have been completely redrafted and updated. *Transnational Cooperation* is a new book. Compared with *Global Collective Action*, this new book is much more reader friendly and accessible, with finer details now placed in footnotes for the interested reader. The current book contains many more examples and references than the earlier book. Unlike *Global Collective Action*, *Transnational Cooperation* has much to say about regionalism, which is growing in importance.

We owe a tremendous debt of gratitude to many people. Iman Shamseldin typed and retyped various drafts of Sandler's chapters. We have profited from insightful comments from five anonymous reviewers on various drafts. We received excellent counsel and encouragement from Scott Parris, the senior economics editor at Oxford University Press (OUP). We also appreciated the efforts of the production staff at OUP, who transformed the typescript into a book. We acknowledge an intellectual debt to our many coauthors of our articles addressing related issues as those covered in the book. Peinhardt thanks his UTD colleagues—Jonas Bunte, Brandon Kinne, and Banks Miller—for many discussions about his issue chapters and for their support during the writing. He is also grateful to Adam Yeeles for help with the map in Chapter 9. Sandler thanks Jeannie Murdock, Justin George, and Khusrav Gaibulloev for helping with the indexes, diagrams, and related

matters. This project succeeded because of the support of our respective wives, Anne Dutia and Jeannie Murdock, and the understanding of our children.

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January 2015

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CHAPTER 1
Transnational Cooperation

Transnational cooperation or successful collective action involves two or more countries working together to achieve an outcome that is more difficult and, in some instances, impossible to obtain through independent efforts. For example, a global standard of weights and measures requires universal consensus—no country can unilaterally declare such a standard. Generally, transnational cooperation is motivated by mutually beneficial payoffs to the cooperating countries. Historically, transnational cooperation involved military alliances, such as the Triple Entente and the Triple Alliance prior to World War I, the Allies and the Axis during World War II, and the North Atlantic Treaty Organization (NATO) and the Warsaw Pact during the Cold War.[1] Other historical examples concerned curbing transfrontier pollution—for example, the resolution of the Trail Smelter dispute between Canada (the polluter) and the United States, which set the precedence for the "polluter pays principle" of environment compensation. For some time, countries have assisted one another during natural disasters, which is a form of collective action. Assisting nation-states hope that others will come to their assistance when they are in need of help.

The world is beset with myriad global, regional, and transnational challenges of varying degrees that require some form of transnational collective action by two or more countries. At the global level, these challenges include curbing climate change, monitoring the heavens for planetesimals, installing safeguards against financial crises, tracking the outbreak of contagious diseases, annihilating transnational terrorist organizations, eliminating human trafficking, isolating new viruses, eradicating infectious diseases, and developing best medical practices. Regionally, challenges encompass

1. On these alliances, see articles by Conybeare, Murdoch, and Sandler (1994) and Conybeare and Sandler (1990), which investigated burden sharing within these alliances based on data on allies' contributions to defense.

ameliorating acid rain, forestalling the spread of invasive species, maintaining watersheds, monitoring the intensity of hurricanes, limiting bank runs, caring for refugees, quelling political violence, and installing tsunami-alert systems. Bilateral challenges include illegal immigration, river pollution, surface ozone, drug trafficking, and cross-border criminal activities.

If we can see into the future, what do we need to know to treat transnational challenges effectively? Our efforts would be greatly enhanced if we knew beforehand what challenges are the most persistent, so that society can take palliative actions immediately against these exigencies. This insight means that scarce resources can be allocated to where they are most needed. Problems that have self-ameliorating mechanisms should not be addressed. Since we cannot truly see the future, we can do the next best thing and apply our understanding of collective action to anticipate these persistent problems.[2] To act decisively, we must second-guess tomorrow's challenges that are either not currently experienced or recognized. This necessitates, in part, thinking about the consequences that new technologies in the development stage or other novel contingencies may have on the environment, human health, the economy, security, and social well-being. This foreknowledge allows us to act sooner, thereby limiting the extent of the harm and reducing the expenditure of palliative resources. Additionally, we must learn which of today's challenges are overblown—for example, invasive species may face natural forces that keep population levels in check once a threshold is reached. Finally, society must have the forethought to develop the requisite infrastructure to alleviate today's and tomorrow's transnational challenges. This infrastructure may require a rotating committee of scientists, drawn from multiple disciplines, to spot these challenges at an incipient stage. Additional monitoring technologies are needed to assist these scientists—for example, atmospheric observatories on Mauna Loa on the island of Hawaii monitor carbon dioxide and other chemicals in the stratosphere. Provision of this infrastructure hinges on international cooperation, founded on transnational and intergenerational awareness, which has surfaced during the twentieth century as countries recognize their interdependencies.

The financial crisis of 2008, which resulted in the "great recession," underscores today's interdependency of countries worldwide. This crisis originated in the United States because of a housing bubble funded in part by subprime mortgages given to borrowers with inadequate incomes to repay the loans.[3] These borrowers were attracted because the loans required little or no money

2. The foundation of the study of collective action began with Mancur Olson's seminal 1965 study. Other noteworthy contributions include Hardin (1982), Marwell and Oliver (1993), and Sandler (1992).

3. There is a copious amount of material on the financial crisis of 2008; for a succinct summary, see Britannica (2009).

down and had initially low interest rates. After a couple of years, the interest rates on these subprime loans became outrageously high. Clauses in these loans did not allow the borrowers to refinance at a lower interest rate, so they had little choice but to default on their loans, which had been sold by the original lender to mortgage-buying institutions. As house prices plunged in some markets in 2007, many recent home purchasers now owned houses with values of less than their mortgages. In reaction, some borrowers defaulted on their loans. Countrywide Financial Corporation, which at the time was the largest mortgage lender in the United States, was a casualty of the financial crisis. Two government-chartered institutions—Fannie Mae and Freddie Mac—which held many more mortgages, lost hundreds of billions owing to defaulted loans. The financial crisis spread to investment firms, such as Bear Stearns, Lehman Brothers, and Merrill Lynch, whose portfolios contained large amounts of mortgage-based securities whose value evaporated with defaulted loans.

The financial crises in the United States spread to Germany, Japan, China, and elsewhere as U.S. imports declined, thereby underscoring how countries' fortunes are integrally tied in today's world with its huge daily flows of financial capital. The recession was especially deep and long lasting because banks became reluctant to lend out money. Commerce hinges on businesses' ability to secure short- and long-term loans. Questionable loan practices in the United States had ripple effects throughout the world markets as liquidity dried up. Subsequently, debts in some European Union (EU) countries—Portugal, Spain, Ireland, Italy, and others—affected stock prices and the speed of recovery in the United States. Given that the Chinese and EU economies have become huge, crises there also reverberate globally. Poor financial practices in key economies can adversely affect economies everywhere. The 2008 recession blindsided the world despite the accumulated experience and knowledge from past financial crises.

MARKET FAILURES AND THE NEED FOR COLLECTIVE ACTION

Markets permit the voluntary exchange of goods and services, guided by prices and profits. Market economies function best when property rights are defined and protected, competition is rigorous, and market information is plentiful. Moreover, markets must be complete, so that anything with value (negative or positive) is traded. Property rights are claims of ownership, written or implicit, that give the owner control over a good's benefits. Laws define property rights, police enforce these rights, and courts adjudicate disagreements over these rights. Quite simply, markets allow for the voluntary exchange of property rights by sellers and buyers; in so doing, prices reflect the value of what is being exchanged. Competition requires a large number of small buyers and sellers, so that no one has a measurable influence on price. If buyers and sellers are informed about prices, profits, and market opportunities, then market information is sufficient for efficient exchange. Finally, markets are complete when no producer or consumer has negative or positive consequences on others that go uncompensated. This last requirement is a tall order, since consumption and production activities may have consequences, not captured by the transaction's price. Until U.S. federal laws outlawed smoking in the workplace, secondhand smoke imposed significant uncompensated costs on nonsmokers not reflected in the price of cigarettes.

In a well-functioning market, prices signal to buyers and sellers where to buy cheaply and where to sell for a profit, respectively. According to Adam Smith and classical economists, individuals are guided by an "invisible hand" to an efficient outcome, where resources gravitate to their most-valued use. The beauty with markets is that there is little or no need for explicit coordination. If governments provide defense, a justice system, education, and infrastructure, then markets will achieve an efficient allocation of resources. However, income distribution may be undesirable because individuals with few marketable skills may starve. Also, unanticipated shocks to the system may result in instabilities, such as financial crises. At the national level, governments are still needed to redistribute income and address instability even when markets work efficiently.

Let us ignore redistribution and instability concerns for the time being and briefly consider how markets can fail to direct resources to their best use, which is a primary concern of this book. Markets may fail in this goal when property rights are not defined or enforced. If, for example, ownership is in common, then property rights in commonly utilized resources are not defined in such a way as to allow for trade. Open-access commons or "common property" involves such valuable things as the atmosphere, where people and firms have dumped their waste products—for example, sulfur emissions from coal-fired power stations. Until the Law of the Seas Treaty, countries could not legally protect their coastal fisheries located some miles offshore, thereby encouraging overfishing by fishing vessels from other countries without regard to the sustainability of the stock. Market failures can also stem from information imperfections. If, for example, an employer cannot monitor workers' effort, then low output on a given day may be due to laziness or random events, such as an Internet outage or substandard raw materials, beyond their control. Laziness must be punished, but this is not the case for randomness. When information is imperfect, resources do not necessarily find their best use because the link between effort and reward is broken. The notion of incomplete markets—another cause of market failure—is tied to externalities, or an uncompensated interdependency. Externalities result in third-party benefits or costs that are not taken into account by the price, thereby distorting resource allocation so that too little