

After the Fall:



The Continuing Role of
Transnational Networks in
International Financial
Regulation

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Financial Crises as Coordination Games



- What's nature of “panic” in financial crises?
- Fundamentally, it's an issue of coordination
 - Classic examples of coordination games
 - ✦ *Where to meet*
 - ✦ *Which side of the road to drive on*
 - ✦ *Standard-setting*
 - In these situations, individual actors choose their strategies based on their expectations of others
- In financial crises, specifically, we see coordination around a sub-optimal equilibrium (e.g., no lending)

Financial Crises as Coordination Games II



- **Classic case: The bank run**
 - Depositors maintain or withdraw deposits, based on expected behavior of others
- **Likewise, in financial crises more generally**
 - Bank lending
 - Private equity investment
 - Currency speculation
 - Individual spending and investment decisions
- **By extension, in important aspects of financial regulation**

How do you solve a problem like coordination?



- Key issue is expectations
- What I do in a coordination setting will depend on what you do, and vice versa
- Consequently, need to shape market participants' expectations of one another
 - ✦ Convince them others are not running against the bank, are lending, are investing, etc.

And how do we do that?

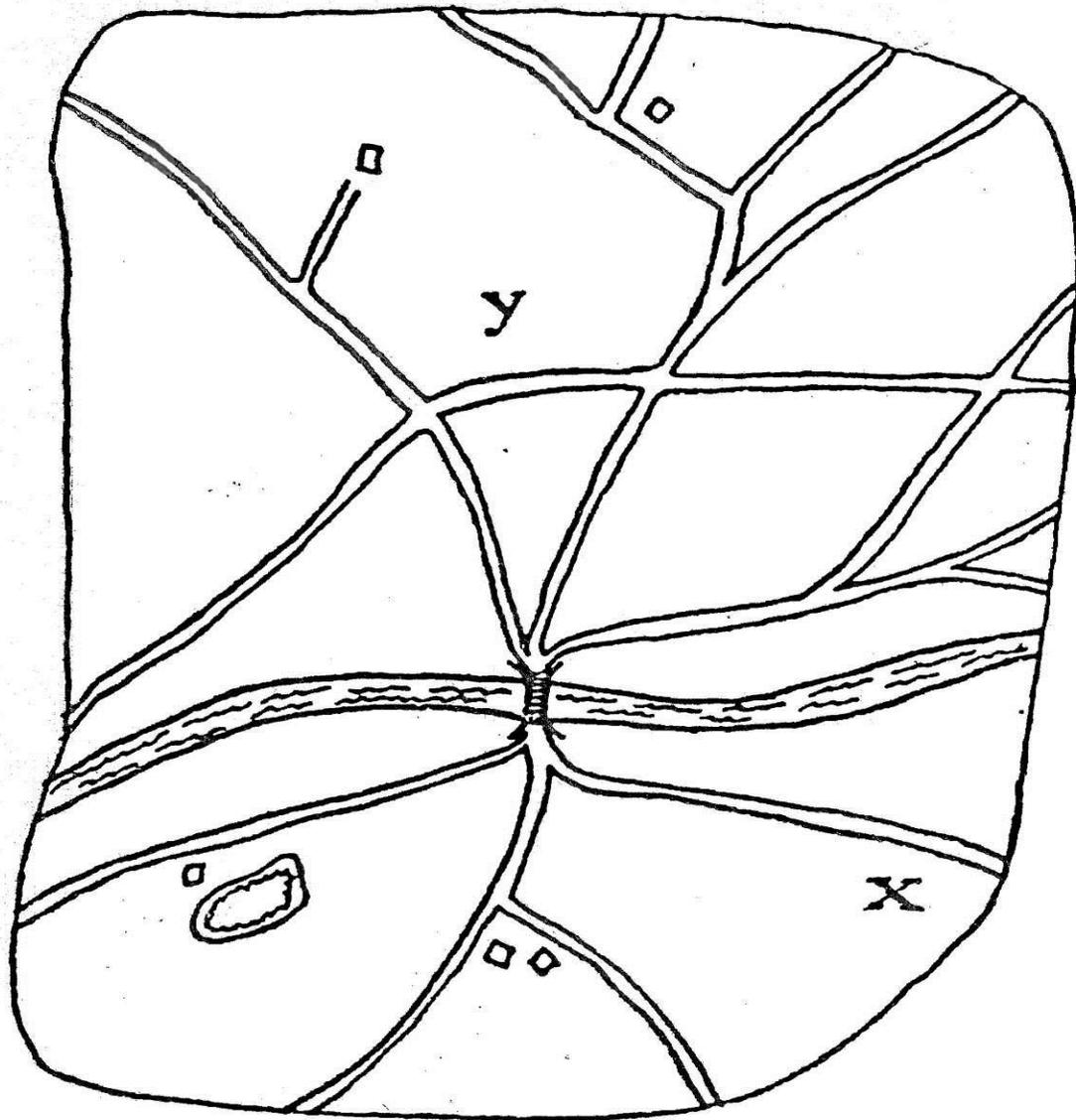


- May occur spontaneously, of course
 - But what do we do, when it doesn't?
- *Potentially*, command-and-control regulation
 - Coercive regulatory interventions, to dictate coordination
 - But not easy to construct, in this setting
- Further, it may be unnecessary
 - Expectations can effectively be shaped by information, non-coercive public or even private behavior, signals, etc.
- A role for regulatory “cues”?
 - “Expressive” law
 - “Norm seeding” (Picker)

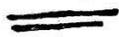
The Role of *Saliience*



- At center of, “saliience” may be crucial
 - In shaping expectations, certain solutions **STAND OUT**
 - Schelling’s “focal points” (e.g., Grand Central Station; paratroopers)
- This may be relevant, of course, to questions of *how* we regulate in coordination settings
- But perhaps especially relevant to questions of institutional design
 - *Who* should regulate?



River



Road



Building



Pond

The Limits of Transnational Regulatory Networks?



- As noted, some critique of capacity of networks in international financial regulation
- In particular, questions of their utility where the operative dynamic is one of conflict/competition, rather than pure coordination
 - Brummer, *Post-American Securities Regulation* (2010)
 - Verdier, *Transnational Regulatory Networks and Their Limits* (2009)

Conflict and Coordination



- But this is not a reason to dismiss the potential contributions of transnational regulatory networks
- The presence of conflict turns out to be fully consistent with a dynamic of coordination
 - And networks can do important work even in – and perhaps *especially* in – conflictual settings
- Can see with the game of “Chicken”
 - Classic coordination game: Hawk-Dove
 - Strong conflict, but still coordination (and no issue of defection), *because my behavior continues to depend on what you do*

The Game of Chicken



Player 2

	Swerve	Don't Swerve
Swerve	(5,5)	(0,10)
Don't Swerve	(10,0)	(-10,-10)

Player 1

The Salience of Networks



- There may, however, be other important limits on the role of transnational regulatory networks
- Specifically, I would suggest, they may not – at least consistently – possess the salience needed for effective coordination
- Can appreciate as much, when we dissect the broad phenomenon of salience into a set determinative factors

Dimensions of Saliience



- **Familiarity**
 - Established vs. newer institutions?
 - Media attention?
- **Visibility**
 - Location?
 - Participation?
- **Singularity/Uniqueness**
 - Multiplicity?
 - Overlap?
 - International vs. national institutions?
- **Authority**
 - Not as end unto itself
 - Perhaps even in a completely different arena

Implications?



- **Recognize limits of networks**
 - Can serve a number of useful functions, but perhaps not key coordination ones
- **Resulting need for relevant international institutions**
 - They present their own issues, of course
 - But perhaps they're inevitable
- **In the meanwhile, though, we do well to think about how to enhance the salience of network structures**
 - At a minimum, attend to determinants of salience
 - ✦ Notable advances, in this regard (e.g., FSB)
 - More fundamentally, develop architecture of a “network of networks”
 - ✦ Create means for effective coordination – and perhaps enhanced singularity/visibility/etc. – among multiplicity of regulatory networks
 - ✦ A kind of “college” of networks, akin to the college of supervisors