desirable to maintain an accession perspective. Some were of the opinion that Turkey has not made a great deal of headway with regard to improving the state of human and social rights within its borders. And some did not agree that Turkey has become more liberal. Others were of the opinion that it is clearly in the EU's strategic interests to encourage Turkey to take an interest in the European Union. The prospect of Turkish membership will recede as the on-going integration of the euro zone continues. And Turkey's eagerness to join the EU seems to be on the wane. Some of the participants wanted to know whether the EU is prepared to face the moment of truth when Turkey actually turns its back on Europe.

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The Governance Report 2013: Focusing on Challenges in Financial and Fiscal Governance

Helmut K. Anheier

Key message

How do we make sense of "governance" in a fast-changing and complex world? What are the main components of good governance? What governance innovations are taking place? And how can we measure governance capacity, performance and outcomes? In The Governance Report 2013, experts assembled by the Hertie School of Governance (Berlin, Germany) offer an analysis of what governance means today and what implications might be drawn by and for policy makers. Focusing in part on challenges in financial and fiscal governance, particularly at the global and European levels, the Report highlights the trade-offs governance actors face in responding to crises and in putting in place policies and institutions that avoid such crises in the first place.

1 Introduction

How do we make sense of "governance" in a fast-changing and complex world? What are the main issues and components of, and for, good governance? What governance innovations are taking place and what is their impact on policy? And how can we measure governance capacity, performance and outcomes?

The Hertie School of Governance in Berlin, Germany has brought together an interdisciplinary team of experts to explore these and other governance questions. The results of this exploration are presented in various formats, e.g., a compact book addressed mainly to policy makers and advisors summarizing the key findings, an edited volume with more in-depth treatment of specific issues geared toward the more scholarly audience, and a website (www.governancereport.org) including additional materials and data beyond what is formally published, which analysts and advisors will find useful.

The first product of this endeavour, "The Governance Report 2013", published by Oxford University Press, offers an analysis of what governance means in the current context of changing conditions and what implications might be drawn by and for policy makers. In doing so, the Report recognizes that we live in a world of diverse policy priorities based on different normative foundations that lend themselves to different interpretations of concepts such as democracy, human rights, justice and equity. Recognizing such differences, the Governance Report explores which policy thinking and rationales as well as organizational arrangements have emerged in response to today's changing realities; which seem to hold promise; and what lessons can be drawn that could help particular actor groups realize their policy goals. In this sense, it can be a valuable resource for policy makers, policy influencers, and those who advise them.

2 Governance and Interdependence

The early 21st century has entered a period of profound uncertainty; many demands are being put on existing governance systems, and new approaches are being tested. The deepening interdependencies among countries and other actors involved in governance have opened up many opportunities but they also involve risk; they invite competition as well as cooperation—and not only among states but also among business corporations, public agencies, and civil society institutions. As recent crises have amply demonstrated, risks and opportunities on the one hand and competition and cooperation on the other are more easily realized and established for private goods and services than for public goods generally, and for global public goods in particular. It is in context of the latter —bringing about policy outcomes that involve cooperation and competition in public goods provision—that governance systems have shown the greatest strains and weaknesses. The inability of the international community to reach agreement on major issues such as the environment, freedom of information, arms or global finance is an obvious example.

The search for new approaches to deal with such issues takes place in a complex world with a seemingly contradictory 'push and pull': Cautious pooling of national sovereignty is met by attempts to repatriate monetary or environmental policy, the growing volume of cross-border economic activity is threatened by protectionism, especially by emerging market economies; the free flow of information, so much facilitated by the rise of the Internet, faces the controlling hand of governments and private corporations alike; social and political movements organise more easily across borders as part of a growing global civil society yet face many restrictions at national levels and find limited access in international organisations. Finally, although more examples could easily point to the 'back and forth' of today's world in other policy fields as well, international people movements, while growing in numbers, show increasing travel restrictions and more selective migration patterns.

Developments towards greater interdependence unfold in the context of major shifts in global power relations since 1989. It seems that the geopolitical dynamics unleashed by the end of the Cold War, the economic globalisation spurt that has gathered new momentum with the rise of emerging market economies, and the advances in information and communication technologies—all appear to threaten the very foundations of many of the successes they themselves helped bring about over recent decades. In an almost dialectic process that would require the pen of a Joseph Schumpeter or Max Weber to describe adequately, the affairs of the world—at the global and even local level—seem to be going backward and forward at the same time, leaving the observer at awe as to the speed and depth of the changes taking place.

How, then, can we make sense of governance in a world that seems to be changing quickly, not necessarily always for the better, and that seems to gain in complexity, even a certain 'messiness' und unpredictability as it moves seemingly forward and backward at the same time? What are the main issues and components of, and for, good governance? What governance innovations are taking place, what options emerge, and what policy recommendations come to mind?

The contributions in The Governance Report 2013 focus attention on institutional changes and innovations that state and non-state actors have adopted, or could adopt, in response to the structural shifts that have been occurring and are likely to become even more pronounced and entrenched in the future. The Report's contributors do not deal with the purely technical and procedural aspects of today's policy challenges; they rather use such policy challenges as a lens to see how different actor groups have adjusted and, of particular interest for policy advisors, could adjust to the new types of challenges brought about by changed and changing governance conditions.

3 Why Governance?

Governance is a broader notion than government and its principal elements of legislature, executive and judiciary. The World Bank (1991) defines governance as the manner in which power is exercised in the management of a country's economic and social resources for development. Note the emphasis on power and management and the nation-state frame.

By contrast, Enderlein et al. (2010: 2) suggest a generic definition of governance that denotes 'the sum of rules and regulations …, processes as well as structures… justified with reference to a public problem' brought about by actors. In other words, governance is about how we approach and solve a recognised collective issue or problem such as public security, poverty or pollution; how we monitor the performance of corporations; and what role civil society plays.

Kooiman and Jentoft (2009) distinguish between first and second order governance. The first is about deciding who can legitimately address what public problem for whom and how; and the second about the kinds of institutions, organisations and regulations needed for achieving desired policy outcomes. First order governance is more about politics, and second order governance more about policies.

But what do these rather abstract terms actually mean? Let us consider a hypothetical case of a group of some 200 cruise ship passengers stranded on an isolated island. They vary by age, gender, education, occupation, and wealth, and there are a few children and frail-elderly among them. They managed to rescue food and medical supplies estimated to last three months and succeeded in obtaining basic tools for constructing shelter from the ship. For some reason, some 100 cases of champagne and 10,000 packs of cigarettes also made it to the island's shore.

The stranded passenger case, familiar to generations of governance students, leads directly to the heart of what governance is about: how to govern what, for what, by or through whom, and according to what rules? This is the first order governance problem. How is the power to make decisions to be distributed in terms of rights and obligations? Should elections be held? Should all adults have equal vote, or should those most knowledgeable and able to function have more influence? Then follow second order issues: should all receive equal portions of food? Who is to oversee the process of dividing and disbursing rations? How should we distribute medicines, and on what basis? Should those building shelter for others be rewarded and enjoy privileges such as the conspicuous consumption of champagne?

In raising these questions, we implicitly address five distinct but related dimensions of governance. First order governance is essentially about power and politics as the interplay between the exercise of legitimate power and its support endowed by stakeholders. Who among the passengers has the right to assume power, how and why? Is power limited and checked? Is it established and maintained by threat of violence or given freely? First order governance is also about the issues at hand and the public problem that needs defining and framing—the second dimension. Is the use of cigarettes a public problem, one with the same priority as looking into water supply or medical care? Defining and framing are closely related to solving or at least suggesting approaches on how to address the public problem.

Second order governance, too, includes two dimensions: first, what rules and regulations are needed, and, second, how are we to enact them? For example, should there be markets, hierarchies, or networks based on communal or family bonds when distributing food? Then there issues about the regulations themselves, and ways of monitoring them, and the checks and balances needed to make sure that rules are observed, and, if violations occur, that sanctions can be applied, and redress and remedial action sought.

The final dimension is the outcome achieved by first and second order governance arrangements. It is about performance and achievement, and the extent to which the governance system in place has brought a solution, obtained a desired level of goal attainment and brought about intended redistribution outcomes, and, especially, the extent to which it enjoys the legitimacy among key stakeholders.

Governance includes multiple actors or stakeholders, multiple levels and policy fields, frequently contested problem frames and definitions. There are spill-ins and spill-outs across levels, actors and fields—the result of the interdependencies characteristic of a globalising world that are also evident at more local levels. In sum, governance is a system of related, nested parts whose interdependence in political, legal and economic terms implies shared scope of autonomy and responsibility. For some actors like governments, this addresses notions of sovereignty and for others degrees of independence and hierarchy. It is these kinds of systems that are of central interest to the Governance Report.

4 Governance Challenge in Focus: Financial and Fiscal Governance

The 2013 edition of The Governance Report highlights the many challenges arising in the field of financial and fiscal governance in Europe and elsewhere. As the Hertie School's Mark Hallerberg and colleagues explain in their chapter (Clark et al., 2013) and in a full section of the companion edited volume (Anheier, 2013 forthcoming), over the past several years the world has experienced a series of financial and fiscal crises. The takeover of Merrill Lynch in March 2008 and the collapse of Lehman Brothers six months later touched off a financial crisis that spread to many parts of the world. Trade dropped precipitously across virtually all countries, and many experienced recessions. Some small countries, first Iceland and Latvia and later Ireland, faced the complete collapse of their banking sectors. Beginning in 2010, the European periphery, including Greece, Portugal, and Ireland, entered a sovereign debt crisis that continues to put pressure on the governance of Europe's common currency. The sovereign debt problems in turn worsen the balance sheets of private sector participants, such as banks.

Though financial and fiscal crises have occurred throughout history (Reinhart & Rogoff, 2009), Hallerberg and colleagues argue that globalisation and higher degrees of interdependence have exacerbated them in recent times. The example of the unfolding and management of the crisis in Europe provides several important lessons in this regard. While problems extend across borders more than before, the jurisdictions for most economic policy remain national. At the same time, decisions national policymakers take create externalities for others. This suggests that coordination of policies across borders may help all countries.

The recent crises also demonstrate that there are no purely technocratic approaches to resolving or even preventing them. In the first place, there are no true apolitical technocrats who can play this function. For example, the International Monetary Fund has tended to favour the interests of its traditional largest shareholders, namely the European Union and the US, and it is not realistic to expect it to propose policies that somehow maximise the economic well-being of others to their detriment. Similarly, central banks are not politically neutral actors that necessarily choose monetary policies that further the broader economic interest.

Policymakers at the national and international levels can usually identify what needs to be done in principle to prevent such crises in the first place or, when shocks or imbalances occur, to adjust accordingly. However, any solution will have winners and losers, especially in the short term, and the political and social consequences will need to be taken into account. Thus, governance actors are faced with 'trade-offs' and determine for themselves which part they prefer, revealing political preferences and not merely technocratic ones. In the case of financial and fiscal governance, especially at the global level, at least three such trade-offs must be resolved:

- **liquidity vs. moral hazard**: In the particular case of crisis lending, a 'bailout' directly benefits a country by providing it with the financing (liquidity) needed to service its debts, while at the same time creates moral hazard, i.e. incentives for borrowers and lenders to assume additional risk in the expectation of future bailouts. This trade-off presents lenders with a difficult choice: lend freely (large amounts on lenient terms) at the risk of increasing future demand for such bailouts, or limit current lending (smaller loans with more extensive conditionality) at the risk of having a country default and triggering a broader financial crisis.
- **accountability vs. effectiveness**: While the creation of powerful new international organisations or the delegation

of further authority to existing ones might strengthen the effectiveness of financial regulation and supervision, they would also present a direct challenge to national sovereignty and democratic accountability. This tension is visible in the discussions of a 'banking union' in the eurozone. One regulator with the ability to investigate and shut down troubled banks would be more effective than the hodgepodge of regulation that now exists. But there remain open questions about accountability: Who appoints the regulator? To whom does this common regulator report? Will domestic populations consider this regulator as democratically legitimate?

- **domestic politics vs. international commitments**: The trade, monetary, and financial policies maximising a government's domestic political support are not necessarily those most conducive to international economic stability. In the end, domestic politics usually trumps international commitments.

In a complex, interdependent world, we need more international institutions. They also need democratic legitimacy. But, as noted above, democratic pressure means that governments tend to favor domestic over international solutions. And those international solutions which do develop come during crises, and they focus on ending the crisis. This stress on crisis resolution means that democratic accountability issues are at best after thoughts. The resulting institutions then lack democratic legitimacy. So--as Reinhart and Rogoff (2009) would also suggest--we are bound to have crises in the future.

Similar trade-offs exist, of course, in other policy fields and at other levels of governance. By identifying such trade-offs, we can better understand the hesitance, reluctance or lack of readiness of governance actors to respond or act in ways that would be logical from a technocratic perspective.

5 Conclusion

As noted at the outset, the Governance Report intends to provide analysis and information that will be useful not only to the academic community, but also policy makers, influencers and those that advise them. The 2013 edition of the compact version of the Report explores various policy challenges of our time from different angles. While Helmut K. Anheier provides a methodological and conceptual introduction on governance systems and on how to measure their performance in Chapter 1: "Governance: What Are the Issues?", Inge Kaul revisits the management of interdependencies from a global public goods perspective in Chapter 2: "Meeting Global Challenges: Assessing Governance Readiness", and introduces the 'responsible sovereignty' paradigm which provides a framework for nation-states to cooperate in resolving difficult global challenges. As described above, William Roberts Clark et al.'s Chapter 3: "Challenge in Focus: Financial and Fiscal Governance" considers the politics of global finance and discusses, in particular, the evolution of financial regulation in Europe. In Chapter 4: "Governance Innovations", Helmut K. Anheier and Sabrina Korreck offer conceptual guidance for understanding governance innovation and present a set of governance innovations that seem to show promise. Chapter 5: "Introducing a New Generation of Governance Indicators" by Helmut K. Anheier, Piero Stanig and Mark Kayser focuses on governance indicators that reflect the Report's multi-level and multi-actor approach to governance and the various lenses of readiness, performance, and innovativeness. A concluding chapter, "Recommendations and Conclusion" written by Helmut K. Anheier, presents the major implications that follow from the Report and spells out concrete policy recommendations, addressing them, to the extent possible, to specific actors and decision makers.

More detailed analyses, including a major section on financial and fiscal issues and chapters on related innovations, are available in the Report's companion volume "Governance Challenges and Innovations: Financial and Fiscal Governance" available through Oxford University Press (August 2013). Future editions of this compact Report and the companion edited volume will present new analyses and track the development of the challenges, innovations and data presented.

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