International Institutions as Common Agencies: Why Do They Encounter Crises?

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An international (economic) institution can be regarded as a common agency for the member countries, and an international treaty can also be regarded as the product of a common agency. The recent development in agency theory implies that an international organization as a common agency would serve the efficiency of the world system under relatively general conditions (Dixit, Grossman, Helpman), such as (1) the no-exit condition that member countries stay as members, (2) the free side-payment condition that member countries can make side payments free of cost, and (3) the incentive compatible condition that member countries are motivated to reveal their preference.

In reality, the WTO looked at the verge of break-down in Cancun, and the Kyoto Protocol has difficulty to be ratified. This paper explores, by emphasizing the difficulty in making direct transfer, the reasons why international organizations do not function as harmoniously as the common agency would predict.

In the framework of the two-level games (Putnam), we introduce the difficulty in making transfer payments or the cost of realizing transfer payments. As pointed by Coate and Morris, direct transfers are not so often observed because political, social and economic costs are involved in direct transfers. Transfers are conducted often in more costly forms.

In this paper, we ask, by explicitly examining the role of transfers among nations as well as among groups,

(1) how the difficulty of making transfer payments obstruct the efficient allocation in the world,
(2) how the decisions to enter the organization are related to the efficiency of the outcomes, and
(3) how, in reverse, the threat of exit by a nation or a group of nations makes difference to the outcome.