Emerging Countries and Basel III: Why is Actor Mobilization so Low?*

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One important effect of the recent global financial crisis is that the membership of key institutions for international regulatory standard-setting, notably the Basel Committee on Banking Supervision, expanded to include emerging country members of the G20. This paper asks why this expansion has not increased the mobilization of emerging country actors on matters addressed in the Basel process. I explore two main explanations of low levels of emerging country actor mobilization: low perceived compliance costs of regulatory proposals, and “bounded rationality” due to knowledge and resource constraints. I argue that there is no strong relationship between emerging actor mobilization and perceived compliance costs, and that bounded rationality has played a more important role. This has important implications for the position of emerging countries in international standard setting and for the legitimacy of international financial governance itself.

Key words: Basel III, emerging countries, interest mobilization, influence, legitimacy.


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In November 2008, G20 leaders in Washington agreed that a select group of major emerging countries should for the first time become full members of the international organizations that negotiate and coordinate international financial regulatory standards: “The Financial Stability Forum (FSF) must expand urgently to a broader membership of emerging economies, and other major standard setting bodies should promptly review their membership.”¹ The “global” financial crisis (GFC) had sharply reinforced a perceived legitimacy deficit in the key institutions of global economic governance, a deficit that had been widening for some years before 2008. The G20, with its less Western-centric membership now held out the promise of an enhanced position for emerging counties – and perhaps developing countries more generally – in a variety of hitherto developed country-dominated international institutions.

The opportunity for emerging countries provided by the crisis was not simply due to their obtaining seats at the top table. The financial crisis had also shaken the confidence in the prevailing approach to financial regulation among advanced economy policymakers. Adair Turner, then chairman of the UK’s Financial Services Authority, noted:

[[I]t’s very important to realise that the really big thing that was wrong was the overall regulatory approach, agreed at global level, and which a

group of very clever people at global level thought was very sophisticated and totally appropriate. In retrospect, Basel 2—the revision of the capital standards of Basel 1 to Basel 2—was an enormous amount of intellectual effort over 10 years, which completely failed to address the fundamental issues. There was far too little capital and liquidity buffers across the global banking systems.\(^2\)

G20 leaders broadly accepted this analysis and directed the Basel Committee on Banking Supervision (BCBS) and other regulators to address the perceived regulatory and supervisory failures promptly. At the Washington summit these leaders promised:

...intensified international cooperation among regulators and strengthening of international standards, where necessary, and their consistent implementation ... to protect against adverse cross-border, regional and global developments affecting international financial stability.\(^3\)

The BCBS, as the primary global standard-setter for banking regulation, was the main locus of the negotiations that ensued. Until 2009, developing countries generally had been excluded from this forum, which the G10 countries had dominated almost exclusively since the mid-1970s (Goodhart 2011). The BCBS agreed to expand its membership to include the G20 non-member countries in March 2009; it now has 27 country members plus the European Union (EU). Of these 27 countries, there are 11 who can be classified as full “emerging” members and another three with observer status.\(^4\) The BCBS, including observers, now has 12


\(^3\) Ibid.

\(^4\) The 11 full emerging country members are Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, and Turkey. The three observers are Chile, Malaysia, and UAE.
members from Europe, eight from Asia, six from the Americas, three from the Middle East & Africa, and one from Oceania. The FSF was renamed the Financial Stability Board (FSB) in 2009 and tasked with the coordination of international financial regulatory reform and ensuring that groups like the BCBS achieved their tasks in a timely fashion; its membership was also similarly expanded.5

Some policymakers in major emerging countries clearly understood by 2008 that they had placed far too much confidence in advanced country technocrats and policymakers. China’s Vice-Premier Wang Qishan is said to have asked in mid-2008 whether he should continue to take his Wall Street teachers’ lessons seriously now that their own authority and credibility was in question (Davies 2008). In his first meeting at the Basel Committee, Liu Mingkang, then China’s longstanding chairman of the China Banking Regulatory Commission (CBRC), apparently made a robust and vocal statement of the shortcomings of existing Basel standards and the need for reform.6

This paper asks how much this promise of and opportunity for greater emerging country involvement has translated into increased mobilization of actors in emerging and developing countries regarding standard setting in international banking regulation. It focuses specifically on the activities of the Basel Committee on Banking Supervision (BCBS), a key locus of financial regulatory reform.

Actor mobilization is, of course, not the same thing as influence. But it may be an important and necessary condition for such influence. To exercise influence in

5 The FSB includes all the full emerging country members of the G20 and the BCBS and three fewer European members, to make 24 country members in total.

6 Author discussion, developed country regulator, September 2014.
international negotiations, national representatives must be able to articulate their preferences on particular issues. Actor mobilization is likely to be correlated with preference articulation: it can be a means by which national preferences are established and can be promoted by the identification of distinct preferences. In addition, as Putnam (1988) argued, the mobilization of domestic interests can shape the “win-set” of national representatives. To the extent that this mobilization shrinks the size of this national win-set, it will (ceteris paribus) increase the international bargaining power of national negotiators. Bargaining power will also be related to market size and position (Drezner 2007: 55).

In the lead up to Basel I in 1988, the ability of US and British regulators to reach preliminary bilateral agreement and jointly to threaten the exclusion of the international operations of foreign-based banks from New York and London was a crucial factor in their ability to exercise substantive influence over outcomes (Oatley and Nabors 1998). This influence derived in part from the centrality of both of these two major international financial centres in the global financial network, which limited others’ potential for exit. Major Japanese banks, the most important target, had no credible alternative to London and New York. Nevertheless, Japanese financial markets had become increasingly important in international finance by the late 1980s, and Japan’s participation in the first Basel accord was also essential for the US and UK. Japanese banks also mobilized domestically and internationally to

7 This is particularly so in the presence of formal ratification procedures in which organized domestic interests might be able to block implementation. BCBS standards as soft international law do not generally require formal ratification, but in many cases domestic implementation requires changes to national legislation.
register their concerns about US and UK proposals and to suggest modifications. This gave Japanese negotiators a source of leverage underestimated by authors such as Oatley and Nabors, reflected in a series of concessions gained by Japan (Chey 2013).

I provide evidence that level of emerging country actor mobilization on these issues remains strikingly low. There are two main alternative explanations for this. The first is that the compliance costs of proposed standards may be relatively low for emerging country actors. If emerging country actors believe that proposed standards will be far more costly for developed country actors than for themselves, the incentive to mobilize in order to lobby for modifications to these proposals will be weak. The second main possibility is that emerging country actors lack the resources, knowledge and capacity to articulate their preferences effectively even in cases where compliance costs are potentially significant. The first possibility assumes that actors understand their interests and preferences and will mobilize when they perceive a need to protect their interests; the second assumes that mobilization can be substantially constrained by organizational resources and knowledge, or a kind of institutional bounded rationality.

The first section of this paper assesses overall levels of interest group mobilization in developed and emerging/developing countries during the phase of the negotiation of key standards associated with Basel III. I show that as in the previous Basel II negotiations, interest mobilization remains a predominantly advanced country phenomenon. Sections two and three assess the compliance costs and bounded rationality explanations respectively. I argue that the evidence points in favour of the second explanation. A final section concludes.
1. How much do emerging country actors mobilize?

As noted above, G20 leaders demanded that international standard setters address perceived failures in the financial regulation and associated institutional architecture. But regulators also faced mounting pressure from these same politicians not to worsen the increasingly difficult post-crisis economic environment. They also very quickly confronted a revived coalition of financial and other private sector actors who argued that proposed new standards would be highly costly both for themselves and for national economies (Lall 2012). These twin pressures were linked, since the coalitions that mobilized against proposals for a significantly more stringent financial regulatory architecture played on political concerns that central bankers and financial regulators might go too far in re-regulating finance.

The most prominent of these private sector critics came from a handful of major developed countries, particularly from firms and organizations associated with the global financial services sector.\(^8\) Measuring mobilization systematically across different kinds of actors is, however, not easy. In this paper I use public commentary on BCBS consultative proposals as a proxy for actor mobilization. These proposals outline draft standards agreed by the Committee and invite comments from interested parties, including from non-BCBS jurisdictions. Both the consultative papers and the comments received have been published on the BCBS website since

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\(^8\) For one of the most well publicized critiques of Basel III along these lines by an international financial lobby group, see IIF (2011).
In the following analysis, I use commentary information from four Basel II and 27 Basel III consultation exercises.

Historically, most of this commentary has come from advanced countries, predominantly from the private sector. Most private sector commentary has come from individual banks and financial sector lobby groups, or private firms closely related to the financial sector. Major international banks and their lobby groups, including institutions such as the American and British Bankers’ Associations and the Institute for International Finance (IIF), have played prominent roles in these commentary processes. However, as Pagliari and Young (2014) have shown in the context of Basel and elsewhere, a surprising amount of commentary has also come from non-financial business groups.

As regards official sector commentary, there is a strong tendency for comments to come from public organizations that are not represented on BCBS. There appears to be a norm that represented organizations should voice any concerns or objections in the BCBS process rather than via public commentary.¹⁰

There are some potential shortcomings of relying on such comments as a proxy for measuring actor mobilization regarding Basel standards. Banks and other private actors may have access to domestic level processes that feed into international policymaking. This could include informal mechanisms of influence as

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⁹ Before 2001, the BCBS only summarized commentary received on their proposals rather than publishing individual comments. After 2001, there was a growing trend towards full publication of comments, though this was not consistently so until the period since 2008.

¹⁰ This was confirmed to the author by one BCBS participant (interview, October 2014). Nevertheless, there are a few cases in which new members (e.g. CBRC) continued to provide public comments on proposals after they had joined.
well as the more formal, consultative kind. It is difficult to measure the relative influence of banks and other actors via informal mechanisms across countries, but even when this is seen to be substantial (e.g. in the cases of the US and the UK) private sector actors still tend to mobilize in formal consultation processes. As regards the latter, a growing number of OECD countries have adopted public notice and comment procedures (OECD 2010, ch.9). This diffusion of this policy trend is also apparent in emerging countries, where it is increasingly common practice to issue draft regulations and to request commentary. For example, in Brazil it is not mandatory but it is now standard practice for securities and insurance regulators to do this; banking regulators increasingly do so but less consistently. The same is true in China and India, though there seems to be persistent uncertainty regarding how responsive authorities are to public commentary. Publication of comments is generally less common in emerging than in developed countries.  

Thus, it is not true that there is no “culture” of responding to regulatory proposals in emerging countries, though it is true that the diffusion of this practice is a relatively recent one. It is difficult to be sure whether national public commentary in emerging countries serves as a substitute for commentary in the Basel process, but there are reasons to doubt that it does. First, actors from developed countries generally provide commentary on both national and Basel proposals and do not seem to restrict themselves to one or the other. Second, and most importantly, national regulatory proposals tend to follow the issued regulatory standards in the

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11 Author correspondence with officials and analysts in Brazil, China, India and Korea.
BCBS fairly closely, suggesting that the window for exercising influence over these regulatory standards is likely to be in the Basel process itself.

This suggests that public commentary on Basel proposals is a reasonable proxy for the level of actor mobilization in international banking regulation. There is a bias in this commentary towards criticism of BCBS proposals: generally, individuals or organizations are motivated to provide comments when they wish to criticize rather than to praise or support draft standards. Still, comparative counts of commentary tell us little about the nature and intensity of objections to proposals. Nor do they tell us whether any influence attempts by emerging market actors, whether inside the Basel Committee process or by actors on the outside, are successful or not.

With these caveats in mind, Figure 1 shows that most commentary on BCBS proposals has been from actors based in advanced countries, not from those in emerging countries, and that this remained true after major emerging countries joined the BCBS and FSB in 2009.
Figure 1: Total comments received by developed country and emerging country (official and private sector) actors, 2001-2014.

Source: BCBS website. Author classifications.\textsuperscript{12}

\textsuperscript{12} Comments from international associations that include actors from emerging countries are not classified as emerging country submissions unless it is the primary objective of the association to represent such actors (e.g. the International Chamber of Commerce, IOSCO and APEC are not classified as emerging country commenters). Individuals writing explicitly on behalf of organizations are classified according to their institutional affiliation rather than their nationality. Multiple submissions by the same entity are counted only once. State-controlled banks are classified as "official" commenters. HSBC definitions of emerging
Commentary in 2001 and 2003 was predominantly related to the “omnibus” second and third consultative papers on the Basel II regime. Since 2008, consultative papers have been concerned with relatively specific components of the Basel regime and these have received fewer comments per paper, with the exception of the major Basel III papers of 2009 on liquidity risk and strengthening resilience. There is a modest average upward trend in total annual commentary. Figure 2 shows total commentary on individual BCBS consultative papers by date of publication.
The rate of emerging country commentary (as a proportion of all commentary) is variable but there is no general upward trend despite the growing importance of emerging countries and the change in their membership status over the period (figure 3). The 2003 and 2011 peaks in Basel II and Basel III commentary by emerging country actors are similar at nearly 20% of all commentary.
There is, however, a clear shift in the nature of emerging market commentary over time. Emerging country commentary was predominantly by official (governmental) organizations in the earlier period when Basel II was being negotiated. In contrast, about 90% of all developed country commentary on the second consultative paper on Basel II came from non-official sector actors. During the Basel III era, there has been a clear shift towards increasing private sector commentary from emerging countries, to the point where private actors are now providing the majority of all emerging market commentary (figure 4). The fall in emerging market commentary probably reflects the new membership status of major emerging countries and the norm for official BCBS actors not to engage in
public commentary. The rising incidence of private sector commentary from emerging countries – a trend of convergence towards the general pattern of developed country commentary – could reflect the growing sophistication of these actors over the past decade. However, commentary by non-official developed country actors continues to dominate total commentary.

![Figure 4: Total public comments by official and private sector actors from emerging countries.](source: BCBS website. For classification method, see notes to figure 1.)

2. **Compliance costs and mobilization**

The stakes for emerging countries in post-crisis financial regulatory coordination were high and remain so. The GFC and its aftermath underlined their
considerable vulnerability to financial instability in advanced countries and their interest in ensuring better regulation and supervision in the United States and the European Union in particular. Most members of the G20 had a strong interest in reducing the overall level of discretion in the implementation of more stringent financial regulatory standards after 2008. All governments had an interest in promoting greater financial stability in major economies. Developed countries also had an interest in ensuring that increases in regulatory stringency were implemented across the major financial centres so as not to undermine national financial competitiveness. Since 2009, the G20, FSB and BCBS have agreed there is a need to pay greater attention to the implementation of international standards, potentially constraining the scope for discretionary national implementation, which has been substantial in the past.\textsuperscript{13} Increased transparency regarding implementation may also have increased market pressure on countries to accept agreed international standards.\textsuperscript{14} Generally, this has arguably raised the importance for many countries of the negotiation of specific standards prior to their domestic implementation.

However, the importance of particular proposals need not make it rational for emerging country actors to mobilize to influence them. If private sector emerging actors face relatively low compliance costs compared to their developed country

\textsuperscript{13} G20 countries all committed for the first time to undertake IMF-World Bank Financial Sector Assessments, the BCBS has a new Regulatory Consistency Assessment Programme, and the FSB and BCBS will both undertake peer reviews of implementation in member jurisdictions.

\textsuperscript{14} For a discussion of the relative importance of market and institutional compliance pressure, see Walter (2008), ch.2.
counterparts, there may be good reasons for the former to lay low. In such circumstances, it may be sufficient for emerging country official representatives to support an agreement that increases regulatory stringency in developed countries as well as measures that promote their full implementation in the US and Europe.

Is there evidence that the compliance costs for emerging market countries of implementing Basel III standards were relatively low? In the only two regulatory implementation reports done by the BCBS for emerging country members to date, for China and Brazil respectively, the review committees found capital compliance costs to be low to moderate, with banks largely positive about Basel III implementation (BCBS 2013a: 6-7, 13; BCBS 2013b: 5-7, 59). An IMF Financial System Stability Assessment for Brazil in 2012 reached similar findings (IMF 2012: 19). Another for India in 2013 (IMF 2013: 19) found that Basel III capital compliance costs for state-owned banks in India are likely to be more significant but manageable. This is not surprising. Compared to many banks in the US and Europe, those in the major emerging countries were much less affected by the GFC. For most emerging market banks, nonperforming assets are comparatively low, internationalization and trading activities are small, domestic deposits are high, and leverage ratios and reliance on wholesale finance are relatively low. The opposite is true for many large advanced country banks, especially those in Europe (McKinsey 2010).

This asymmetry in compliance costs is probably most marked for China, where the authorities chose to exceed Basel III standards in stringency in several respects (BCBS 2013a: Annex 11). The relatively strong position for Chinese banks in particular is in sharp contrast with the position of Asian emerging countries in the
wake of the crises of the late 1990s, when Basel compliance costs were high and resistance to full implementation was substantial (Walter 2008).

Although there is evidence to suggest that the overall costs of compliance of Basel III for banks in major emerging countries is lower than that for many developed country banks, it may be that there are significant differences in the costs of compliance with particular components of Basel III. If emerging country actor mobilization was mainly a function of perceived compliance costs, we would expect to see higher mobilization regarding proposed standards for which perceived costs for such actors was higher than average. But which proposed standards are likely to inflict higher compliance costs for emerging country actors?

One relevant source of data is the FSB, which with the encouragement of G20 leaders has been monitoring the potential unintended consequences of post-GFC reforms on emerging and developing economies (EMDEs) since 2012 (FSB 2013). The BCBS has also been requested specifically to monitor the implications of new Basel standards for EMDEs and has done so through the Basel Consultative Group (BCG). The BCG includes regulatory authorities from countries that are not G20 members, such as Bulgaria, the Czech Republic, Dubai, Georgia, Hungary, Kazakhstan, Malaysia, Peru, the Philippines, Poland, Qatar, Thailand, Tunisia, and the West African monetary union. Consultations with these and other G20 EMDEs suggest that there is general concern about the potentially adverse implications of particular new Basel III standards, including those on capital, liquidity, OTC derivatives markets, and G-SIFIs. There is particular concern in EMDEs about Basel III liquidity standards

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15 G-SIFIs are global systemically important financial institutions.
because of the relative shortage of high quality liquid assets in such countries and because of the difficulty of applying these standards to smaller banks and countries (FSB 2013). Among other things, the BCG added to this list concerns about the implementation costs of the countercyclical capital buffer (CCB) and standards for domestic systemically important banks (D-SIBs) (BCBS 2014b: 6, 15).

Do we see higher rates of emerging country actor commentary in these areas, where EMDE authorities have specifically raised concerns? Figure 5 shows that the rate of emerging market private commentary compared to all commentary was comparatively high for some Basel consultative papers, notably own credit risk adjustments to derivatives and disclosure requirements for liquidity ratios and capital ratios, but in these cases total comments were well below average.
We can look at aggregate commentary by emerging country official and private sector actors in areas where EMDE authorities have indicated that they are concerned about the potential costs for emerging and developing countries. What is clear is that there is no general trend for commentary to be higher for proposed Basel III standards in areas of relatively “high” concern. The exceptions are the two 2009 Basel consultative papers on liquidity and strengthening resilience (which focused on increased capital requirements). In these two cases, both official and private sector commentary peaked. But, as noted earlier, this was even more true for private sector commentary by developed country actors, so that emerging country actors are not unusually highly mobilized in these cases – they may have been bandwagoning on high developed country actor mobilization. In addition, even
in these areas, the total level of official and private sector commentary by emerging country actors remains strikingly small. In the peak case, *Strengthening Resilience* (2009), there are only eight emerging official and 14 emerging private actor comments in total. If we exclude the two 2009 papers, the total aggregate commentary by emerging country official and private sector actors on Basel III proposals is actually lower in areas of indicated EMDE concern than in areas of lower concern.
This evidence is suggestive that there is not a strong relationship between emerging country actors’ perceived relative compliance costs for Basel III standards and their levels of mobilization, as measured by commentary on different Basel standards.

A closer look at the content of commentary can also provide useful information. To do this, I consider mobilization on two Basel III consultative papers that the BCP consultations suggest raise significant issues for emerging countries: the countercyclical capital buffer (published July 16, 2010) and domestic systemically important banks (published June 29, 2012).

The countercyclical capital buffer (CCB) is part of the new macroprudential focus of regulation in Basel III, intended to counteract the perceived pro-cyclical bias...
of existing bank capital regulation by raising capital requirements during periods of excessive credit growth (BCBS 2011: 7). The BCBS, in addition to agreeing the principle of a variable CCB that would be additional to minimum bank capital requirements, has also provided guidance on implementation. This includes its size (0-2.5% of risk weighted assets) and the way in which national authorities might identify triggers for increasing the size of the buffer, with above-trend credit growth seen as a key indicator (BCBS 2010a). Measuring what constitutes above-trend credit growth is especially challenging in emerging economies in which financial development and liberalization may be occurring simultaneously. Given that bank lending dominates financing in most emerging economies, the potential for the CCB to constrain economic growth in these economies is significant. A number of emerging country banks have also indicated concern with the CCB.\footnote{E.g., “Asian bankers reject counter-cyclical capital buffer as effective tool for supervision,” Risk.net, June 8, 2012.} Again, we might expect a relatively high propensity for bank and nonbank interests in emerging countries to mobilize on this issue.

Surprisingly, emerging country commentary on the CCB paper was slightly lower than average and equally dispersed between public and private sector actors (at only 5% of total comments each). Commentary provided by actors from emerging country BCBS members was also strikingly low: only actors from Argentina, China and South Korea submitted comments (figure 7). Of these, South Korean banks were the most prominent commentators, with only one set of comments each from an
Argentine bank association and a Chinese individual.\footnote{This individual was employed in a regional branch of the CBRC but wrote in a personal capacity.} In all three cases, as with emerging market commentary in general, comments were also shorter than average and critical of only some of the detail of the CCB.\footnote{The Industrial Bank of Korea’s comments came close to general objection, however.} By contrast, criticism by advanced country private sector actors tended to be both much more detailed and more extensive (e.g. from the IIF). The majority of private sector commentary on the CCB comes from financial associations and firms in G20 countries, especially from the UK, the USA, and Belgium. Firms outside of the financial sector, with the exception of consultancy firms specializing in financial advice and analysis, generally failed to mobilize on the CCB paper, in contrast to other issues (e.g. derivatives – see Pagliari and Young 2014).
Figure 7: Total comments and average page length of comments on the July 2010 Countercyclical Capital Buffer paper, by origin country and organization type.

Source: BCBS website. International associations (e.g. the Institute for International Finance and the World Council of Credit Unions) are located by headquarters. For page length, cover and blank pages were not counted, but notes, references and biographical data were.

The BCBS (2012) paper on domestic systemically important banks (D-SIBs) complemented the Basel Committee’s proposals of 2011 regarding the application of more stringent regulatory standards to global systemically important banks (G-SIBSs). This strategy was in line with the Committee’s general concern to address the negative externalities associated with systemically large financial institutions, including competitive distortions, increased financial fragility and the systemic impact of their failure or impairment. As for G-SIBs, the paper proposed more stringent capital requirements for D-SIBs to address the negative externalities
associated with their size and importance in domestic financial systems and economies. However, it was less prescriptive than in the G-SIB proposals, emphasizing the need for national discretion depending on the circumstances of particular countries, including on the recommendation that D-SIBs be subject to higher loss absorbency requirements (BCBS 2012: 2). This greater level of allowed national discretion could have meant that it was of less concern to large emerging market banks and their clients, making it less likely for these actors to mobilize and to comment on the proposal. On the other hand, a BCBS proposal to allow a high level of national discretion in levying higher capital requirements on D-SIBs could be seen as more of a threat than a more prescriptive, weak standard. The proposal allowed national authorities to impose higher additional capital requirements than those to be levied on G-SIBs and required that they be met in full by common equity capital, for example (BCBS 2012: 3-4). As in the CCB case, it is therefore reasonable to expect a relatively high mobilization of emerging market private actors on the D-SIB proposals.

However, figure 8 shows a similar pattern to the commentary on the CCB paper. Most comments on the D-SIB proposal are from private sector actors in advanced economies, with only one submission from each of nine emerging economies, of which five are BCBS members. Emerging market commentary came from a variety of actors, mostly private financial firms and associations (BCBS members) and regulators (non-BCBS members). The main patterns are a low overall level of emerging market commentary, particularly from private sector actors, and the absence of commentary by non-financial firms not directly associated with the banking sector.
The limited amount of commentary by private sector actors from emerging countries on this proposal did not for the most part adopt a principled objection. Once again, Korean banks were among the better organized of emerging private sector actors. The Korean Federation of Banks argued that the BCBS should be more prescriptive, setting a maximum level of additional loss-absorbing capital requirements for D-SIBs so as to reduce the scope for national discretion, and for the additional capital charge not to exceed that applied to G-SIBs (2.5% of risk-weighted assets, and 3.5% in exceptional cases). They also suggested the BCBS substantially relax the requirement that all additional capital be in the form of common equity. This suggests some concern among Korean banks that domestic regulators might be tempted to adopt relatively punitive capital requirements for D-SIBs.
To summarize, advanced country private sector actors continue to play the dominant role in mobilizing to provide comments on proposed BCBS regulatory standards. The level of emerging country actor mobilization – as measured by commentary on Basel proposals – has not substantially increased since the early 2000s during the negotiation of Basel II. This is revealing given the enhanced focus on enforcement of agreed standards since 2008. There has been a modest shift towards a greater mobilization by private relative to official emerging country actors. However, even in areas where we might have expected higher emerging country actor mobilization because of reported concerns about relatively high compliance costs, it remains surprisingly low.

3. **Bounded rationality? Knowledge, resources and mobilization**

The alternative possibility is that emerging country actors lack sufficient knowledge, expertise, and capacity compared to firms and organizations in more advanced countries to engage effectively with the processes of Basel standard-setting, even when their substantive interests are at stake.

In assessing this alternative, it is useful to begin with an important case that would seem to be inconsistent with it. Emerging countries became concerned in 2009 about Basel proposals to increase risk weightings for on and off-balance sheet commitments and to disallow exceptions to a 100% “credit conversion factor” (CCF) for contingent liability trade finance in the calculation of banks’ minimum leverage ratios. They believed that these proposals failed to take sufficient account of the low
risks entailed by most trade finance and that it could have a significant negative impact on the provision of such finance and thus on their economies.

Korea raised the issue with other Asian countries and the EU in the months before the Seoul G20 summit in November 2010. Importantly, and in contrast to the CCB and D-SIB proposals, a cross-industry coalition of private sector actors mobilized to lobby regulators on this issue. The International Chamber of Commerce (ICC) played a central coordination role in this mobilization and in ensuring that sufficient resources were devoted to providing an effective response. This prompted the Basel Committee to undertake an evaluation exercise with the ICC, the World Bank and the World Trade Organization. An ICC survey of banks and firms in many countries revealed extensive concern in a variety of industries and countries (ICC 2009). In October 2011, the BCBS issued a revised proposal on *The Treatment of Trade Finance under the Basel Capital Framework*, which proposed two technical changes to the earlier proposals and explicitly took into account the potential impact on low income countries (Buckley et al. 2014). In early 2014, the BCBS also moved earlier than it had previously indicated to modify its leverage ratio proposal to apply the same credit conversion factors (CCFs) as in the Standardized Approach to credit risk, which will permit CCFs lower than 100% for contingent commitments in trade finance (BCBS 2014a).

This case might be seen as suggesting that when economy-wide compliance costs of Basel proposals for emerging countries loom large, they mobilize effectively.

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19 ICC and Asian Development Bank (ADB) data showed that even in the sharp global downturn in trade and output over 2008-9, default rates on trade finance remained exceptionally low (and recovery rates given default were relatively high).
However, there were factors specific to this case that reduced the negative effects of low capacity and expertise on actor mobilization. First, although the issues involved in risk-weighting trade finance commitments and in applying appropriate CCFs for contingencies are not straightforward, most emerging country officials, banks and firms could easily understand that they had a strong interest in ensuring that the supply and cost of trade finance did not worsen. Second, and more importantly, major international organizations including the World Bank, WTO and the Asian Development Bank assisted by devoting resources and expertise to understanding the potential implications of Basel III for trade finance and in proposing revisions to Basel proposals. For the private sector, the ICC played a pivotal role in coordinating the cross-industry coalition, which included developed, emerging and developing country firms. Third, more developed trade-dependent countries in Europe were willing to join this coalition and to lobby the Basel Committee from the inside to modify its proposals. Thus, in this case emerging and developing countries were able to make common cause with far better resourced and knowledgeable private and official actors from more advanced countries.

This case points to a more general, structural factor in the position of emerging countries in the global political economy. Over the past few decades, emerging countries have become far more important in networks of international trade than they are in international finance (figure 9). The relative symmetry of trade networks produces greater potential for overlapping coalitions of developed and emerging countries of the trade finance kind (though also greater potential for conflict).
Figure 9: Network of international goods flows 1980 vs. 2011 (top) vs. network of international financial flows, 2002 and 2012.


Figure 9 also emphasizes how asymmetrical networks of global finance remain by comparison with trade. The US and Western Europe (particularly London, still the world’s most important international finance centre) remain the two most important nodes in global finance, with Japan still by far the most important country in Asia. China is the world’s second largest national economy and the largest goods exporter, but it remains less important than Japan in international finance. This is related to China’s restrictiveness as regards capital flows, currency convertibility and
foreign-controlled banks operating in its domestic market. India and Brazil also have relatively closed domestic banking and financial markets and although their banks have begun moving abroad, they are far less internationalized than were Japan’s by the late 1980s. Table 1 gives another indication of the comparative level of connectedness of G20 and BCBS members in international trade and finance. By country, the overall patterns are less apparent than in figure 9 but it generally suggests that a number of major BCBS emerging country members are less financially connected than some small developed countries. 20

20 Note also that these indices from McKinsey Global Institute give a strong weight to current account surpluses, which boosts the indices of countries like China and South Korea and reduces those for the UK and USA. This underestimates the importance of the latter in global financial markets. The global financial centres index ranking (GFCI) gives one indication of the importance of London and New York.
Table 1: Connectedness indices in goods trade and finance for selected countries (2012), and Global Financial Center Index (GFCI) ranking in 2010 of the most important national financial centre. G20 members are in **bold**; BCBS members in *italics*; emerging countries highlighted.

The asymmetry between developed and emerging countries in international banking is even greater than figure 9 or table 1 indicate. Figure 10 shows the stock of external assets of banks in Bank for International Settlements reporting countries at the end of 2007 and 2010. Despite the rapid growth in aggregate economic size of a number of major emerging countries in recent decades, they often remain negligible players in cross-border banking. For example, figure 10 shows that Brazil and India are both insignificant in international bank lending. Data for China are not collected, but international lending by Chinese banks is also thought to be low. International banking, of course, is the core concern of the Basel Committee and of the regulatory standards that it agrees and disseminates.
Figure 10: External assets of banks in BIS reporting countries, $billions, 2007 and 2010.

Source: BIS international banking statistics. Note that data is not yet collected from some new Basel Committee members. Countries ranked in ascending order by external asset positions in 2010.

Without direct access to the deliberations of the BCBS and FSB and their various committees it is difficult to assess directly the variation in knowledge,
expertise and resources of different member countries. However, it seems likely that
the persisting unimportance of emerging country banks in cross-border finance is
likely to be a substantial constraint on the knowledge and expertise of its regulatory
officials and private sector actors in the subject matter of BCBS deliberations.

Before the GFC, the Basel Committee often argued that their narrow
membership of 13 advanced countries was justified because these countries
accounted for the great majority of international financial activity and were home or
host jurisdictions for most of the major global banks, giving them special expertise in
the regulation and supervision of these firms. The expansion of the membership of
the BCBS and related bodies in 2009 was less because this deep inequality in
financial activity and expertise had changed and much more because the dominance
of this important area of international economic governance by a small group of
advanced countries had become politically unsustainable. Politics rather than large
increases in the financial importance and regulatory expertise of emerging countries
drove the expansion of the BCBS and FSB in 2009.

This has put new emerging country members in a difficult position. Although
they had a direct interest in ensuring that Basel III and associated new agreements
did not impose serious costs on them, knowledge and resource constraints
combined with uncertainty means that these costs that can be difficult to assess a
priori. They might only become apparent in the longer term (Sheng and Li 2013).
Emerging countries often also lack the private sector expertise available to advanced
country officials that can help them to formulate their preferences on regulatory
proposals. Some also argue that there is a greater “culture of deference” in
emerging countries, or deep skepticism that it is worth the effort, which deters firms from lobbying and providing information to regulatory officials. If so, this may reinforce the dilemma in which such officials find themselves in forums like BCBS and FSB.

The complexity of the reform agenda and the speed with which key decisions have been made further disadvantages emerging country members. After 2009, when there were two (very complex) proposed revisions, there has been a steady increase in the number of proposed standards – in 2013 there were 11. The BCBS has required comments to be submitted within a range of three weeks to four months, but even the latter period can be short for countries that face serious shortages of resources and expertise. Complex, multi-issue agendas with short decision periods can substantially favour those actors with substantial resources, experience and expertise (see also Lall 2012). Just as in many other walks of life, actors that lack these things tend to be much less vocal, less consulted, and can find it difficult to enhance their reputation among better qualified peers.

Evidence from different but related organizations supports the conclusion that knowledge and expertise constraints are important factors in explaining generally low levels of emerging country actor mobilization in international financial standard-setting. Within powerful private sector financial associations that include both developed and emerging country members, the same phenomenon seems to be at work. The Institute for International Finance, perhaps the most important of these associations with a privileged relationship with the Basel Committee, has 40 working groups on a variety of financial regulatory issues. In the experience of one
participant in a variety of these committees, emerging country participants rarely participate and appear to be “on a very steep learning curve” on most of these issues.\textsuperscript{21}

What we know of the deliberations of the Basel Committee also suggests that new emerging members were not vocal participants in the negotiations over specific standards. Sheila Bair, in one of the few published accounts we have of the negotiations, portrays the negotiations over new capital standards as a pitched battle between developed country representatives who favoured significantly higher capital requirements (the UK, Switzerland, and some of the US delegation) and those opposed (France, Germany, Japan and others in the US delegation). To the extent other members are mentioned, these seem to have been bystanders and largely to have aligned with the former camp (Bair 2012: chap.22).\textsuperscript{22} The final result was a compromise between these two camps: minimum core capital requirements have increased and a variety of other new standards have been added, but heavy reliance on the previous risk weighting approach persists and the new minimum simple leverage ratio of three percent of tangible assets remains permissive.\textsuperscript{23} Thus, in terms of the dominant players and outcomes, there appear to be strong elements of continuity with the pre-existing Basel regime (see also Lall 2012).

\textsuperscript{21} Comments to author from IIF working group participant, October 2014.
\textsuperscript{23} For a brief summary of the nature and negotiation of Basel III and predecessor agreements, see \url{http://www.bis.org/bcbs/history.htm}. 
This is not to suggest that major emerging countries completely lacked voice and influence in the Basel process after they entered in 2009. There is evidence that the expanded membership of the BCBS led to greater attention to the potential impact of new standards on emerging economies. For example, in its guidance on the implementation of the CCB, the BCBS emphasized a “credit-to-GDP gap” indicator – the gap between the aggregate private sector credit-to-GDP ratio and its long term trend – rather than simple above-trend credit growth as a key indicator of a potential buildup of systemic risk. In its 2010 guidance, it noted that “[p]articular consideration was given to the question of how to take to take account of jurisdictions with financial systems at different stages of development” (BCBS 2010a: 10).24

Similarly, in the case of the D-SIB proposals, the emphasis on the need for national discretion in the setting of additional capital requirements for D-SIBs would have helped to negate any concern of emerging country regulators in the BCBS process that they would be overly constrained by these new standards. At the same time, the proposal that regulators also be permitted to apply more stringent regulation to large domestic banks could have been seen by such regulators as a welcome potential source of political leverage at home (on the specific interests of regulators in Basel, see Singer 2007 and Chey 2013).

24 Nevertheless, concerns remain that a relative lack of reliable historical data may hamper the implementation of the CCB in emerging economies. In its illustrative exercise on the identification of the credit-to-GDP gap in BCBS countries, credit growth data for most emerging members – Argentina, Brazil, China, India, Indonesia, Russia and Saudi Arabia – was much more limited than for advanced country members, dating back only to the early 2000s at best (see BCBS 2010a: 19-24).
4. Conclusion

These examples of increased sensitivity of the Basel process to emerging members do not negate the overall picture of persisting low levels of mobilization and engagement of emerging country actors in international financial standard setting. The evidence broadly supports the view that mobilization and engagement is driven less by perceived compliance costs of Basel proposals than by knowledge and resource constraints facing emerging country actors.

What are the implications? Low interest mobilization by private sector actors from emerging countries may give a greater degree of autonomy to national representatives at Basel and FSB. But what will these regulatory officials do with this relative autonomy if they lack the knowledge and expertise to weigh in on specific issues? The likely outcome is that these officials will be relatively passive, learning from the process rather than actively shaping its course. In the case of Basel III, the results were arguably not disastrous for emerging countries as they could support a compromise between advanced country hawks and doves that would increase financial stability in the US and Europe without imposing excessive costs on emerging economies. But if knowledge and resource constraints are the main reason for low emerging country actor engagement in international financial standard-setting, there is a danger that their longer term interests may be

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25 Lall (2012) and Wolf (2014) argue that the mobilization of advanced country financial sector interests was so extensive and effective that they succeeded in completely watering down the impact of earlier proposals for greater regulatory stringency. If this view is correct, emerging country representatives may have failed to achieve their objective of ensuring greater financial stability in the largest advanced country economies. The jury is still out on this question.
compromised. This is not only a threat to emerging countries, as it may also reduce the legitimacy of this important aspect of international economic governance itself.
References


