10 Chinese Attitudes towards Global Financial Regulatory Cooperation: Revisionist or Status Quo?

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International financial regulatory cooperation since its beginnings in the early 1970s has been dominated by a handful of advanced countries. Until very recently, almost all developing countries played no significant role in the formulation of global regulatory norms and standards. After the global financial crisis of 2008-9, the G 20, which had itself displaced the G-7 as the key grouping in global economic governance, directed all of the major global institutions involved in standard-setting to undertake reforms to their governance structure so as to reflect the changed political environment. Accordingly, a number of emerging market countries have been brought into the inner of global regulatory standard setting, including organizations such as the Basel Committee (BCBS), IOSCO, IASB, and the FSB. Most of these institutions remain, along with the G20 itself, dominated by advanced countries from Europe and North America.[1] Nevertheless, the crisis has brought some major emerging market countries into the inner circles of global regulatory standard-setting for the first time (see table 1 in Chapter 1). As the introductory chapter in this volume notes, the expanded role of major developing countries in the process of international standard setting raises crucial questions about the significance of the crisis and the future of global economic governance. But how do the major emerging countries approach global standard-setting and how (if at all) has the recent crisis affected their attitudes towards it?

Rather than tackle this large question directly, in this chapter I focus on the attitudes of one important newcomer, China. In various international forums, China is increasingly seen as the pivotal, even the "indispensable" emerging country, partly reflected in the various recent calls for the creation of a narrower "G2" US-China forum of global economic governance. Whether China will prove to be the most important developing country in global standard setting remains to be seen, but few would doubt its potential in this regard. We have already seen that one consequence of the crisis is that a variety of Chinese officials have openly argued that the dollar's position as the world's reserve currency is undesirable and needs to change.[2] Is China also likely to call for similarly radical changes in approaches to financial regulation? As Alastair Iain Johnson has asked in another context, is China's approach to global regulatory standard setting likely to be revisionist or (as Johnson himself argues) is it more likely to reflect a "growing convergence of the Chinese leadership's interests with the ideology and interests of these status quo institutions"? (Johnson 2003: 11, fn.20). Similar questions could be asked of other important emerging countries such as India and Brazil but China's position might still help to determine the overall balance of tendencies within the G20, FSB and associated groups. Furthermore, there are good reasons, including China's hybrid form of capitalism, to believe that China is among those countries which are more likely to adopt a relatively critical attitude towards the dominant western approach to financial regulation.

In addressing this question I focus on Chinese attitudes to banking regulation and standard setting within the Basle Committee. This narrow scope is justifiable because banks have been at the centre of this crisis, because they also remain at the centre of China's financial system and economy, and because the Basle regime has probably been both the main target of criticism and the main locus of current reform efforts. I argue that the attitudes of Chinese officialdom towards the Basle regime on the eve of the current global crisis had become fairly status quo oriented. These attitudes were driven in part by the Asian crisis of the late 1990s and the dominant interpretation of its causes. In policy terms, the government increasingly emphasized the importance of China's steady adoption of international standards, particularly those disseminated by the BCBS.

The current crisis represents a new and important challenge to this strategy and has caused some in China to question the current trajectory of banking regulation and supervision. It has also made it more difficult to judge whether any major country's attitude on financial regulation is status quo or revisionist, since, as the introductory chapter in this volume argues, the regime itself is in flux. Important voices in countries associated with the status quo ante like the US and UK have argued for changes to financial regulation and to the Basle regime more specifically that only a few years ago would have been seen as radical. Some Chinese officials have echoed many of these criticisms. On balance, however, Chinese official attitudes remain fairly mainstream by comparison with more critical voices in advanced countries and in some respects are more conservative. They are also more conservative compared to China's evolving approaches in related policy areas, notably in the government's increasingly critical views on the governance of the international monetary system and the US dollar's position within it. The main reason for this more mainstream approach towards the Basle regime, I suggest, is that key actors in China's domestic political economy continue to see advantages in continuing to import financial regulatory and managerial "technology" from the advanced countries and see considerable costs in any destabilization and discrediting of the regime.

In the first section of this chapter I discuss briefly how we might measure revisionist and status quo tendencies in global economic governance and financial standard setting in particular. In the second section I outline Chinese attitudes to banking regulation before and after the crisis and how we might explain them. The third section concludes and asks what these might imply for the future of global economic governance in this area.

HOW SHOULD WE MEASURE REVISIONIST AND STATUS QUO TENDENCIES IN FINANCIAL REGULATION?

Most scholars of international relations associate status quo tendencies with those states that dominate the processes of international rule and norm-making and who are seen generally to benefit from them. Following Gilpin (1981: 34) and Johnson (2003: 9-11), it seems most helpful to focus on the way in which the leaders of the state speak about and act towards specific international rules and norms. Here, I adapt Johnson's approach of investigating the degree to which particular countries are "proactive… in challenging the formal and informal rules of the major institutions in the international system that most other actors support most of the time" (Johnson 2003: 11). For Johnson, a revisionist state is one which does not participate actively in major international institutions, which breaks the rules and norms of those international institutions in which it does participate, or which temporarily abides by the rules and norms but when presented with the opportunity tries to alter them in ways inconsistent with the original purposes of the institution and community.[3]

All of these three measures raise difficulties of interpretation and application. On the question of participation, since the key international standard setting institutions for financial regulation have had highly restricted rather than universal memberships, membership has simply not been a matter of choice for most countries. Nevertheless, most countries in the world have in fact adopted many of the standards issued by these institutions; the Basle capital adequacy regime is one of the best examples of this phenomenon. Thus, one way forward in cases of non-membership is to infer from a government's statements about the rules and norms of international institutions the degree to which it sees these international institutions and the rules and standards they issue as legitimate. In addition, recent offers of membership by all the major international standard setting bodies to other G20 countries provides one test of their willingness to participate. On the question of behavioural conformity, there is much debate over whether most countries have adopted Basle and other international standards voluntarily or whether they have effectively been coerced by a combination of market and official external pressure (Ho 2002; Simmons 2001; Soederberg, Menz and Cerny 2005). Even where countries have adopted international standards, the levels of effective compliance with them has varied widely, in part because of successful resistance by powerful domestic interests (Walter 2008). There is also uncertainty about what constitutes core norms, and even standards themselves can be ambiguous. This can make it difficult to reach a definitive judgement about the degree of national acceptance of particular rules and norms, but the focus here will be primarily upon the national leadership and the question of private sector compliance will be largely avoided.

In addition, rather than discuss in detail China's attitude towards the many standards issued by the BCBS, I focus here on the central capital adequacy standards and in particular on the government's attitudes towards the core norms of the regime. These core norms can be summarized as system stability, competitive equality, and market self-regulation. The Basle Committee was established to improve the quality of banking supervision worldwide and, where possible, to develop common guidelines and supervisory standards (Kapstein 1994; Singer 2007; Tarullo 2008). In the capital adequacy regime, first developed in 1988 ("Basle I"), the explicit objectives were to strengthen the stability of the international banking system and to ensure a high degree of consistency in application across countries so as to diminish competitive inequalities among international banks (BCBS 1988: 1). These two core norms of system stability and competitive equality have remained central to the Committee's recent activities, including in the development of the Basle II framework over 1999-2004 and its subsequent revisions (although one could argue that the BCBS placed greater emphasis on the stability norm in Basle II and aimed to tilt the competitive playing field in favour of relatively sophisticated international banks). The third self-regulation norm has been more implicit and more recent. It emerged in the course of the BCBS's work from the mid-1990s, beginning with the market risk amendment to Basle I in January 1996, in which there was a presumption that stability would be best achieved by encouraging banks to use internal models to manage their portfolio risks and capital. This third norm had an increasing impact over time on the specific standards agreed by the Committee, notably in Basle II, though it is also this norm that has been subject to most criticism since the outbreak of the latest crisis.

Similar considerations apply to the question of whether a particular country tries to alter the rules and norms of an international organization when the opportunity presents itself. There has not yet been sufficient time to judge the approach of newcomers in the BCBS and the other international bodies to which they have only recently been admitted. Generally, however, a country may be more likely to challenge existing rules and norms if it has a strong perception that past conformity was coerced or that the costs and benefits of convergence were very asymmetrically distributed. Again, official statements concerning the motivation for the adoption of international rules and norms and about the consequences of such adoption can be helpful in discerning attitudes and, perhaps, the likelihood of future revisionism. We should also distinguish between criticism of particular international standards and a revisionist approach to the regime as a whole. This is particularly important in the current crisis and associated international reform debates, since key aspects of the Basle regime have been subject to withering criticism. This has been true for the Basle II capital adequacy regime in particular, which is now generally agreed to have left major international banks seriously undercapitalized and to have amplified rather than dampened the global credit cycle (Brunnermeier et al. 2009). Those national authorities most associated with the status quo ante have largely accepted these criticisms (FSA 2009; US Treasury 2009). At the same time, these authorities have committed themselves to pursue revisions to the bank capital regime through the Basle Committee, and bank capitalization standards and the BCBS itself both remain central to global financial regulation. Although the norm of market self-regulation is now in some doubt, the system stability norm remains intact; and there are not many indications of a general willingness to depart from the competitive equality norm.

In the case of China and Basle standards, then, we can operationalise Johnson's three questions as follows. First, has China accepted core Basle norms and standards and has its approach to them changed in response to the current crisis? Second, what are the leadership's motivations regarding its stance towards these norms and standards? Third, what is the leadership's perception of the distributive consequences of the Basle regime? The next section addresses each of these questions in turn.

CHINA AND THE BASLE CAPITAL ADEQUACY REGIME

Does China accept core Basle norms and standards?

China's evident willingness to join the BCBS in 2009, as well as a range of other related global standard setting institutions, could be taken to imply a general acceptance of the norms and standards associated with the regime. However, participation in international institutions does not by itself indicate a willingness to accept the status quo ante (Johnson 2003:13). Better evidence can be found in the Chinese leadership's voluntary adoption of the Basle capital adequacy standard in the mid-1990s. In this regard, China was no exception to the general tendency of developing country adoption of the Basle regime in this period, although it was a relatively late adopter by the standards of most Asian countries. Although the intention of the BCBS had been to develop a common capitalization standard only for international banks from advanced countries, most national authorities at this time appeared to believe that Basle I was also reasonably appropriate and unproblematic for developing countries. Some argue that developing countries had little choice given that Basle compliance effectively became a prerequisite for participation in international financial markets, but in fact Basle I entailed relatively low compliance costs and permitted substantial autonomy for national authorities and banks. Furthermore, for China at this time, there was no expectation that its state-owned, domestically oriented banking system would either internationalize or be opened to foreign competition.

There is much evidence that substantive compliance with Basle I was often very poor in many Asian and other developing countries before 1997-8 despite widespread formal compliance (Walter 2008). This was particularly true in China. The Basle minimum capital adequacy ratio (CAR) of eight percent of risk weighted assets was adopted in article 39 of the law of the People's Bank of China (PBC) of 1995 (Brehm and Macht 2004: 322), but it was not enforced. In this respect, the PBC took a general tendency in Asia to an extreme, and it raises questions about the degree of acceptance of key Basle norms and standards by the Chinese leadership at this time. This strategy satisfied those officials who viewed the Basle regime as part of a set of legitimate technocratic international standards, but also those economic and political interests who would have suffered had the rules been strictly enforced. Among the latter, this certainly included powerful factional elements within the party-state apparatus that benefited from a system in which access to bank credit was determined by national and local political interests (Shih 2008). For those reformers who believed that the government needed to tackle seriously the weaknesses of China's financial sector, the adoption of Basle rules mainly held out the possibility of stricter regulation in the future.

If the level of commitment by the Chinese leadership to Basle norms and rules in the mid-1990s was therefore ambivalent and conflicted, there is evidence of a move towards a much greater degree of acceptance in the late 1990s. Zhu Rongji, who became Premier in March 1998, launched a series of financial reforms that indicated a much stronger desire to adopt and implement Basle standards. The first phase of reform focused on the recapitalization of the major state-owned commercial banks (SOCBs) and the disposal of nonperforming loans (NPLs); the second phase, from 2003, focused on the reorganization of these banks, the adoption of modern management practices, new governance structures, and foreign listing (Liu 2007; Luo 2008). Recapitalization was premised on a greater willingness to enforce the minimum eight percent CAR for the major banks. New rules on loan classification similar to those being adopted elsewhere in Asia were also introduced in 1998, and new accounting and loan loss provisioning rules were introduced in 2001 and 2002 respectively.

Wen Jiabao, Zhu's protégé and successor, continued this reform path from 2003. Restoring the solvency of China's major banks remained the key leadership priority. The creation in 2003 of the China Banking Regulatory Commission (CBRC), which took over from the PBC as China's principal bank regulator, was intended to force China's banking system onto a commercial footing so as to ensure that it was no longer the Achilles heel of the economy.[4] The law establishing the CBRC drew heavily on the Basle Core Principles for Effective Banking Supervision, of which the capital adequacy regime is one part, and from other rules prevailing in the advanced countries, especially the US. The composition of the CBRC's International Advisory Board is also intended to send a strong signal of the regulatory authorities' intentions to converge upon what were at the time essentially western standards of banking regulation and supervision.[5]

Hong Kong, a relatively sophisticated financial centre with one of the most westernized approaches to financial regulation in the region, was an important source of regulatory innovation for the mainland during this phase. Andrew Sheng, the former Chairman of the Hong Kong Securities and Futures Commission, played an important role as convenor of the CBRC's International Advisory Board and later became the CBRC's chief advisor. David Carse, former chief executive of the Hong Kong Monetary Authority, also became a member of the International Advisory Board. For the major SOCBs themselves, Hong Kong listings were an important step in their internal reorganizations and gave them access to foreign capital and managerial expertise.

Luo Ping, then in the International Department of the CBRC, stated bluntly in November 2003 that "[b]esides [their] low capital base and asset quality, banks in China also suffer from poor corporate governance and internal controls and a lack of adequate risk management skills" (Luo 2003: 4). Even according to official figures, banking system

NPLs in 2003 were still 18 per cent of total loans, down from 30 per cent in 2001 (unofficial estimates were often much higher). Over 2003-4, the CBRC signalled an ambitious timetable for Basle I implementation by the beginning of 2007, introduced the same five-tier system of loan classification as had other Asian countries, and moved NPLs to state-owned asset management companies.[6] The 2004 legislation slightly revised the main regulations, combining most of the capital requirements of Basle I with the supervisory review and disclosure aspects (pillars two and three) of Basle II.[7] Chinese officials referred to this selective but more active approach to international convergence in shorthand as "Basle 1.5".

More recently, the large listed SOCBs have adopted the more advanced International Financial Reporting Standards (IFRS) system of loan classification and reporting. According to the CBRC (2007: 147), the proportion of banking system assets in banks compliant with Basle I was a mere 0.6 per cent in 2003 but by early 2008 the figure was just over 80 per cent. This indicates gradual but substantial progress towards convergence on Basle I (Davies 2008; Luo 2008). It also demonstrates, however, the weak enforcement capacity of the Chinese regulatory system and points to the continuing absence of complete consensus within China regarding the full implementation of Basle standards. The CBRC had said that it would close banks that were non-compliant with Basle I by the end of 2006, but in spite of IMF urging, this threat turned out to be empty. Even the smaller banks in China, it seems, are too big to fail. Many of these weaker banks were controlled by city governments, who refused to inject the necessary capital, underlining the political limits of rule enforcement. The ongoing difficulties of the CBRC in dealing with the restructuring and recapitalisation of the much larger Agricultural Bank of China (ABC) also indicate these political limits. Even so, it is doubtful that China is unusual in this respect, particularly though not only among developing countries.

The perceived success of this reform programme and the growing strength of China's major banks led eventually to a more ambitious though still partial approach to convergence on Basle II. A senior CBRC official argued in April 2006 that:

As a major milestone for banking supervision, Basel II is the way forward for all supervisors globally. But the timing for adoption is to be determined by non-G10 countries in light of their own market conditions. Emerging markets should capitalize on Basel II in jumping up the learning curve for better risk management (Luo 2006).

In practice, China's approach to Basle II has been a bifurcated one. The major SOCBs with an international presence would be required to implement the Internal Ratings Based (IRB) approach (with the advanced, “A-IRB” approach the preferred option) before the end of 2010, with other banks following only on a voluntary basis. In February 2007, the CBRC issued “Guidance on the Implementation of the New Capital Accord by the China Banking Industry.” This set out the plan for implementation, though it referred to the need to do so “based on China's realities” (CBRC 2007: 70). As with many other areas of reform, Basle II will be implemented only gradually in China. The standardized approach would be available to banks that do not qualify for the IRB approach, but they were required to draw up a plan to adopt the IRB approach within three years – i.e. no later than 2013 (CBRC 2007: 72). In the meantime, other banks would be required to implement Basle 1.5, eventually moving onto Basle II some years later.

Again, however, China is not particularly unique in this respect. Even in the US, the adoption of Basle II has been highly contested and subject to considerable delay, even before the recent crisis further politicized this issue (Herring 2007; Tarullo 2008). Indeed, China's “Basle 1.5” solution mirrored one of the major options considered but eventually rejected by American regulators. In contrast to the EU, the US government has also decided to adopt a bifurcated approach, with only the major money centre banks being required to adopt the A-IRB approach. And although there must be major doubts about the ability of Chinese regulators fully to implement Basle II for the major SOCBs, similar doubts remain for many countries.

How, if at all, have China’s attitudes to the Basle regime changed in response to the crisis? The initial reaction of the authorities was to insist that Basle II implementation in China remained on track and that the crisis revealed not so much weaknesses in Basle II but the US failure adequately to regulate mortgages, securitisation, the shadow banking sector, and off-balance sheet financing vehicles generally (Luo 2008). In October 2008, CBRC even brought forward the deadline for Basle II implementation by the IRB banks by one year (KPMG 2009). This lags a number of advanced countries (including Hong Kong) but it is similar to the US timetable.[8] The move mainly reflected a concern to maintain the main benchmarks and trajectory of the reform process in the face of increased domestic resistance during the downturn.[9] More recently, as the global crisis worsened and the Basle regime became subject to increasing criticism in the advanced countries, China's position shifted. Some Chinese officials became more willing to engage in open criticism of the Basle regime (Luo 2009). Behind the scenes, Vice-Premier Wang Qisheng is said to have asked in summer 2008 whether he should continue to take his Wall Street teachers' lessons seriously, now that their own authority and credibility is in question (Davies 2008).

However, specific criticisms by Chinese officials of the Basle regime have largely echoed those of officials elsewhere, including in the US, UK, and other advanced countries. Attitudes among the advanced country members of the BCBS have shifted markedly as the crisis delegitimized the market self-regulation norm and those parts of the Basle II regime associated with it (for example, static capital and provisioning requirements, extensive reliance on internal bank risk models and on external ratings, low capital requirements for positions on bank trading books, insufficient attention to bank liquidity risks, etc). China's views have moved in a similar direction, but they remain within the mainstream of the Basle Committee membership. When China was offered membership in the BCBS, it accepted, which in itself indicates a degree of acceptance of the Committee's continuing legitimacy as the key locus of global standard setting in this area in spite of its past mistakes.

The main trend in Chinese official thinking about the Basle process, then, has been towards a growing even if still qualified commitment to its core Basle norms and standards from the late 1990s. This was even true, notably, as regards the third norm of market self-regulation and associated Basle II standards. The Basle regime is now in a process of flux and reform, making it difficult to describe any major country's attitude towards it as "status quo". Nevertheless, China's attitude towards the regime can still be described as mainstream rather than revisionist or rejectionist, in the sense that the government's approach remains broadly supportive of the Basle Committee's evolving response to the weaknesses in the financial regulatory regime revealed by the crisis.

What are the leadership's motivations regarding its stance towards Basle norms and standards?

What has motivated this trend in Chinese policy attitudes? One possibility is that a growing acceptance of the Basle regime is consistent with China's general desire to be seen to be playing by international rules, and its associated sensitivity to any suggestions to the contrary. Although this does explain a broad tendency in Chinese policy, including its recent acceptance of the offer of membership in the BCBS and other standard-setting bodies, it does not help to explain either China's increasing adherence to Basle over time or the variation in its acceptance of international norms and rules across different issue-areas. China has been willing to behave inconsistently with international norms if the leadership deems that conformity would represent a threat to important interests (most conspicuously in the area of the protection of human rights). Initially, the Chinese leadership's adherence to Basle standards was arguably fairly superficial: it satisfied the goal of signaling conformity with accepted international standards whilst avoiding tackling deep-seated problems in the financial sector and the domestic political economy generally. From about 1998, however, Zhu's strategy of restoring the solvency of the banking sector involved confronting powerful domestic vested interests by narrowing the compliance gap.

I argue that there are three main factors that explain China's broad acceptance of core Basle norms and standards and of the BCBS as the legitimate authority in this policy area. First, China's banking sector remains relatively backward in comparison with the largest banks from advanced countries and their restructuring and reform is an unfinished process. This provides both the Chinese leadership and the major SOCBs with a strong incentive to import regulatory and managerial technologies from abroad, without compromising national control over the banking sector. Second, the main state agencies with regulatory and supervisory responsibilities, the CBRC and the PBC, have a strong bureaucratic interest in using global standard setting to leverage their limited autonomy in the domestic policy process. Third, after years of reform, China's financial system faired relatively well during the 2008-9 crisis. The absence of crisis-related government bailouts of banks has meant that banking regulation has been less politicized in China compared to the advanced countries and compared to China's own more controversial currency and reserve policies, permitting the authorities greater autonomy in this policy area.

The first factor is arguably the most important. The Basle regime has been a useful tool that the leadership has used to pursue the long and difficult task of domestic financial reform. The key event in this regard was probably the Asian crisis of 1997-8, which alerted China's leadership to the dangers posed by an unreformed financial sector for the sustainability of growth and even the communist party's grip on power. This might seem obvious, but there is considerable disagreement among both foreign and domestic experts on the significance of the Asian crisis for the Chinese government's approach to financial reform.[10] Some argue that after the late 1980s the Chinese leadership never seriously believed that China would either need to resort to IMF borrowing and conditionality or, despite the high level of NPLs in China’s banking system, suffer a Korean or Indonesian-style financial meltdown. Others argue that the Asian crisis was a shock for the Chinese leadership, leading to a greater fear of a major banking sector crisis and prompting a major policy revision. The SOCBs had been relieved of existing NPLs in the mid-1990s and the PBC had provided new capital injections, but new NPLs continually emerged as efforts to move them to a more commercial, profit-oriented footing failed.

It seems likely that there was considerable debate and disagreement within the Chinese leadership over the relevance and implications of the Asian crisis for China, but the Asian crisis does seem to have had two important effects. First, it strengthened the hand of Zhu and his allies by providing an additional reason for tackling financial reform much more seriously than in the past. Second, even if the consensus view was that a similar crisis was unlikely in China (particularly given the virtual absence of foreign borrowing), the crises in other Asian developing countries and Japan undermined any viable Asian alternative to Western standards in financial regulation. For example, there was discussion among policy elites before the crisis about the possibility of China adopting aspects of the Korean regulatory framework, itself based largely upon Japan’s, but this was dropped after 1997.[11] The Asian crisis effectively meant that there was only one game left in town as regards financial regulation.

Thus, from early 1998, the Chinese leadership increasingly accepted that there was a very large gap between China's own domestic financial system and regulatory framework and those of the most advanced countries that dominated standard-setting institutions like the BCBS. The strategy of using membership in important international institutions to overcome domestic resistance to reform has often been deployed by the leadership (Bergsten et al. 2008: 13). Increasingly, like Korea, Indonesia and Thailand, China looked away from its Asian neighbours towards the Anglo-Saxon countries for reform models. Above all, when international standards proved too general for reform purposes, Chinese officials looked towards US rules and practices.[12] The normative dominance of the US approach to financial regulation was enhanced by the Asian crisis and the comparative resilience of the US economy and its financial system in the face of periodic setbacks (notably the LTCM and the dot.com collapses). The increasingly undisputed legitimacy claims of international financial standards and of the closely associated Anglo-Saxon approach to financial regulation and governance provided a powerful weapon which Chinese reformers, as elsewhere in Asia, used to sideline opponents of reform (Walter 2008: 18-27).

As voluntary standards, they have also had the major advantage of allowing the Chinese leadership to pick and choose only what it needed from western financial regulatory models, to adapt them to Chinese domestic circumstances, and to maintain a gradualist approach to reform. To give one example, enhanced competition was one of the key elements in the post-Asian crisis reform package and one that the IMF-intervened Asian countries had little choice but to accept. For all emerging countries, the average percentage of banking system assets in banks that are at least 50 per cent foreign owned increased from about 20 to 33 per cent over 2000-6; Indonesia, Korea, and Thailand are now at the average.[13] For China, by contrast, the figure remains less than three percent.[14] Heavy financial repression also remains a key characteristic of China's financial system (Lardy 2008). In discussions with the IMF and foreign government officials, Chinese officials often accepted the applicability of international standards, but they emphasized that China would continue to move slowly in some areas.

This explanation of Chinese acceptance of the Basle regime emphasizes the overriding importance of domestic economic and political objectives for the government. This is not to claim that international factors were irrelevant: the importance of the Asian crisis in encouraging China's leadership to tackle financial reform more seriously strongly suggests otherwise. China's other international commitments, particularly the agreement under its negotiated WTO entry in 2001 partially to liberalize the financial sector, may also have increased the urgency of financial reform, though the importance of this factor may be doubted given the limited concessions made in this area. This explanation also implies that although the Chinese leadership largely accepted the core Basle norm of system stability, it is more doubtful whether it accepted the competitive equality norm. The Chinese authorities state explicitly that one objective of Basle II implementation is to improve the competitiveness of Chinese banks (CBRC 2007: 71; Luo 2008: 5). This has required a politically subordinated CBRC to act variously as cheerleader and regulator of the major banks, a difficult balancing act which creates a serious policy tension, though one that has parallels with regulators in other countries, including the US and UK.

For example, although the government has tried to push the SOCBs onto a more commercial footing, the CBRC opposed the removal of the cap on deposit interest rates on the grounds that it would reduce bank profitability. Continuing low deposit rates result in considerable financial repression in China, which benefits banks at the expense of depositors. But this also benefits the major banks, which are flush with deposits, at the expense of the more deposit-constrained joint stock banks.[15] The SOCBs and some of the joint stock banks have in fact been very keen on the adoption of Basle II and IFRS, as well as in joining international banking organizations such as the Institute of International Finance (IIF).[16] Adopting these international standards has allowed these banks to attract foreign investors and management techniques, improve their credit ratings, increase their attractiveness vis-à-vis domestic competitors, and expand their foreign activities. Just like China's regulators, the SOCBs' visible commitment to core international standards is seen as important for building reputation and confidence. Thus, although the primary impetus for Basle convergence has come from China's political leadership, the reform strategy has been strengthened by the fact that it has accorded considerable competitive advantages to the major SOCBs.

The second factor, that China's key regulatory agencies have a strong interest in promoting the legitimacy of Basle norms and standards, is related to the first. It also helps to explain why officials in these agencies see little to gain from calling their legitimacy into question after the 2008-9 crisis. The CBRC in particular had powerful incentives to portray Basle standards to its domestic audience as technocratic, externally validated, best practice regulatory benchmarks towards which China should move. This helped it to carve out a greater (though still limited) degree of operational autonomy vis-à-vis local political authorities, the banks, and the large state-owned enterprises that remain dependent on them. The Chinese political leadership had an interest in supporting this bureaucratic quest for greater operational autonomy, since it distances the leadership from politically difficult decisions about individual banks.

Nevertheless, CBRC's autonomy remains very limited, as its inability to close non-Basle compliant banks in 2007 demonstrated. The Party remains the dominant player in such decisions, as it does for senior managerial and board appointments. Formally, the CBRC, like the PBC, is an implementing agency of the State Council. Bank heads are vice-governors within the government and four out of five of those of the large SOCBs sit on the Party's Central Committee. This political subordination of banks limits the impact of CBRC oversight, strategic investor stakes, and market constraints. As long as competition remains limited, state ownership and party control predominates, lending decisions remain politicized, and bank staff incentives are oriented towards political priorities rather than economic risk management, basic distortions are likely to remain in place (Brehm 2008; Dobson and Kashyap 2006).

These distortions have been even more conspicuous since 2008, when the political leadership has judged it necessary to override prudential objectives in order to stimulate bank lending. Total new domestic bank loans over the first half of 2009 were over seven trillion RMB, nearly three times the rate of the equivalent period in 2008.[17] Given the significantly higher level of financial distress and overcapacity in the economy in 2009, this implies that many of these new loans may become non-performing in the future. The *Financial Times* claimed that the central bank and CBRC have "deep misgivings" about the leadership's willingness to set aside prudential controls in the crisis.[18]

Given the difficult political position in which bank regulators find themselves in China, they have a strong interest in portraying key prudential rules as legitimate and externally validated, not least in order to obtain the support of the political leadership. The willingness of the leadership to accept this argument has probably been substantially diminished by the 2008-9 crisis. This underlines the point that the most important factor in convergence towards the Basle regime has been the leadership's willingness to use it as a means of pursuing long term financial reform.

The third factor that helps to explain the Chinese leadership's willingness and ability to sustain a gradualist approach to Basle convergence is the relatively low levels of politicization of banking regulation in China. The very nature of international standards has permitted less politicization: they have allowed the retention of Chinese sovereignty and they had the important advantage that they were not urged upon China by the IMF or the US (in contrast to the issues of RMB revaluation and financial liberalization above and beyond China's WTO commitments). The fact that the rest of Asia was moving in the same direction from the late 1990s provided additional domestic political cover.

Domestic critics of China's financial system have also largely agreed with the strategy of importing international standards, since they generally argue that political intervention in bank management and lending is the root cause of the banks' problems.[19]

After the 2008-9 crisis, the relative health of the major SOCBs, their insulation from the catastrophic mistakes of more sophisticated international banks, and the commitment of the BCBS to reform has meant that the leadership's broad approach to financial regulation has not come under serious domestic attack. This is in sharp contrast to the government's currency policy and related accumulation of US government debt, where growing domestic criticism has forced the government into a more defensive position that is more critical of the status quo. The continued support from the major SOCBs for formal convergence on the Basle regime, and the willingness of the government to engage in substantial regulatory forbearance during the crisis, has also helped to limit the political costs of the government's strategy.

In summary, the Chinese authorities have accepted Basle norms and standards to an increasing degree over the past decade as part of a strategy of increasing the financial strength and profitability of the major SOCBs. The Asian crisis of the late 1990s played an important motivating role in this strategy and in promoting China's acceptance of the financial stability norm. The SOCBs have been major beneficiaries of this convergence process and have strengthened considerably their domestic and international positions, using Hong Kong in particular as a springboard for international expansion and a source of capital, managerial expertise and risk management technology. This indicated a growing acceptance of the third Basle norm of self-regulation for the major banks, though the level of acceptance of the competitive equality norm was never high. Although the 2008-9 crisis led to increasing criticism of some aspects of the Basle regime and of the self-regulation norm in particular, the Basle regime remains a useful long term benchmark for financial sector reform in China. Its political value for the leadership rests precisely in its flexibility, which has been especially conspicuous during the latest crisis.

What is China's perception of the distributive consequences of the Basle regime?

Among developing countries in general, developments within the Basle Committee in the late 1990s proved more contentious than in the past. The negotiation and agreement on the Core Principles for Effective Banking Supervision in 1997 and, in 1999, the beginning of the negotiations that led eventually to Basle II demonstrated the increasing power of the BCBS as an international standard setter. Many developing countries became increasingly concerned that the G10-dominated body would press ahead with new international standards that would not take developing country interests into account. Such concerns led the BCBS to establish a Core Principles Liaison Group with some important emerging market members (not including China) to improve the legitimacy of the process. The Committee also sought to engage in a much more extensive process of outreach to all of the countries not represented in the Basle II negotiations.

These efforts failed to dispel the view in much of the developing world that consultation was in practice minimal and mostly a fig leaf for the continuing dominance of the G10 countries in global standard setting. The related G7-led initiative to use the IMF and

World Bank to promote and assess compliance with international standards through the FSAP further increased perceptions of inequality, since this initiative was targeted at developing countries and because the major countries seemed either unwilling to participate (the US) or to take FSAP reviews very seriously (the UK).

Many developing countries were particularly critical of the Basle II proposals, which they feared would impose substantial costs on them whilst benefiting the sophisticated international banks concentrated in the advanced countries by permitting them to hold less capital (Powell 2004). There was also an explicit intention to require higher bank capital charges for lending to less creditworthy borrowers, which are especially concentrated in developing countries. Even the “basic” standardized approach was evidently developed for advanced country banks and would involve major implementation costs and an additional capital charge for operating risk at a time when many developing countries, including China, were still in the process of implementing Basle I. The new emphasis on the use of external ratings also seemed to ignore the widespread criticisms of the performance of ratings agencies in recent emerging market crises, as well as the small number of developing country banks and firms with credit ratings. Despite these concerns, the Basle II agreement made few concessions to developing country criticisms. This time, most developing countries appeared to have little choice but to accept an international regulatory agreement that imposed larger costs on them than on those countries that negotiated the agreement.

Chinese officials have been willing to voice all of these concerns, but it is not clear that these distributive shortcomings of Basle II impose significant costs on China and its major banks. As noted above, China has implemented the Basle regime selectively on its own terms, and it remains in a strong position to resist external interference in the process of domestic financial reform. Until 2008, the Chinese government resisted giving a commitment to undertake an FSAP (the US government's own reluctance to do so strengthened this position). But given the anodyne nature of most FSAP reports (which can be edited by national authorities) and the considerable progress that China has made in recent years, it is hardly at risk of receiving a highly critical report.

The net benefits of the Basle convergence for the major SOCBs also appear to have been substantial despite the no doubt considerable costs of adopting new risk management and reporting methods. Their rising profitability, liquidity and credit ratings, along with their sheer size, have catapulted them into the league of the world's largest and best capitalized banks. Some of their smaller joint stock competitors may be disadvantaged but their interests have not been a major concern of the government. Any lingering concerns that Basle II would favour the largest western banks in the longer term have probably evaporated after the crisis; if anything, the largest and most complex western banks may even be disadvantaged by more stringent future capital requirements. At the macroeconomic level, the costs that Basle II may impose upon developing economies that are net borrowers in the global financial system do not apply to China. Unlike other surplus countries such as Korea, China has been a consistent net creditor vis-à-vis BIS banks (IMF 2008: 46). Indeed, if Basle II deters international banks from lending to developing countries, this might even benefit China given its growing ability and willingness to provide its own financial assistance to other developing countries.

In short, although Chinese officials accept many of the standard developing country criticisms of the Basle regime, China's ability to deploy Basle standards selectively as part of its financial sector reforms arguably make it one of the regime's major beneficiaries. This judgement also applies to the major Chinese SOCBs. This helps to explain the increasing willingness of China's leadership to accept the main elements of the global banking regulation regime and, despite the recent crisis, to continue to adopt a mainstream position as regards its reform. It also suggests that China may not be a strong advocate of developing country interests in the BCBS, except to the extent that this is consistent with China's own domestic interests.

CONCLUSION: CHINA's MAINSTREAM POSITION AND ITS IMPLICATIONS

I have argued that China's adherence to core Basle norms and capitalization standards has increased substantially over time, particularly since 1998. Before the recent crisis, China could more accurately be described as more status quo than revisionist with respect to the main elements of the regime. In the wake of the crisis, China has been critical of key aspects of the Basle regime but these criticisms are now mainstream and broadly consistent with the emerging reform consensus in the Basle Committee (Wellink 2009). As the consensus within the BCBS has evolved, China's own position has moved in a similar direction. Indeed, Chinese officials have for the most part refrained from making criticisms of the regime that are as conspicuous, direct and fundamental as those made, for example, by the UK's own financial regulator (FSA 2009). This reflects the Chinese leadership's view that the Basle regime remains a useful tool for achieving domestic financial reform, as well as the lower levels of politicization of financial regulation in China.

Although the Asian crisis was an important motivation for the Chinese leadership's growing acceptance of Basle norms and standards, China's convergence cannot be seen as either grudging or driven by powerful forces of external constraint. Instead, the Chinese leadership has successfully used the Basle regime to promote financial sector reform without sacrificing much autonomy or control over the process. The embeddedness of the major SOCBs in the Chinese political economy has not been significantly reduced, while their profitability and financial strength has been significantly increased. Nor has China's commitment to the Basle regime required it to sacrifice much in the way of increased financial sector openness and competitive equality; on the contrary, Basle convergence has allowed China to strengthen its major banks whilst protecting their dominant position at home. In this latter respect, China's adherence to Basle norms has been qualified, though the same could be said of the US and UK, who saw Basle II as providing a competitive advantage for what they once believed to be their most sophisticated banks. China's adherence has also been qualified by the often large gap between formal and substantive convergence on Basle standards, a gap that has increased once again over 2008-9.

The current crisis has reinforced the Basle stability norm in particular, but it has undermined the self-regulation norm. Recently, Chinese officials have spoken critically of this aspect of the regime, but they have not contested openly the other two core norms, nor have they indicated that their policy of gradual convergence towards its standards will be substantially delayed by the crisis. The BCBS remains the only game in town for Beijing and its membership of this body reduces the likelihood of rival standards emerging.

How far does this argument apply to other areas of financial regulation? Chinese financial markets remain relatively underdeveloped in areas like investment banking, hedge funds and derivatives markets. In these areas, Chinese official opinion has always been more skeptical of Anglo-Saxon attitudes and the crisis has certainly reinforced the view that Chinese banks' relative unsophistication helped them to avoid the worst mistakes of their foreign rivals. This may mean that China will side with other critics of these more exotic forms of finance, which include most developing countries, as well as much of continental Europe and Japan. On the other hand, China's limited interest in allowing banks to expand rapidly into these kinds of activities suggests that these are unlikely to be high priorities for Chinese officials in the near future. The government's confidence that it will be able to pick and choose from international standards according to national requirements could reinforce this view.

With relatively little to disagree with, Chinese representatives in Basle and elsewhere may well adopt their traditional strategy of keeping a low profile whilst listening and learning. The consequences for global economic governance may thus be less dramatic than many expect or hope. They are especially likely to resist any proposals that might reduce their national autonomy and control over the process of financial sector reform. If China continues in a position of broad consistency with the evolving mainstream position in institutions such as the FSB, BCBS and IASB, this will likely weaken the position of those countries favouring a more radical stance.

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[1] For details, see Chapter 1 of this volume.

[2] "China attacks dollar's dominance", *FT.com*, July 9, 2009.

[3] I leave aside Johnson's two other indicators relating to preferences about the distribution of power in the international system, as they are difficult to relate directly to the issue area in which I am interested.

[4] However, the PBC retains a substantial supervisory role so that the Chinese model in this respect occupies an intermediate position between the US and UK systems.

[5] As of 2007, members of this advisory board were: Jaime Caruana, Director, IMF Monetary and Capital Markets Department and former Chairman, BCBS; Gerald Corrigan, Managing Director, Goldman Sachs and former President, FRBNY; Andrew Crockett, President, JP Morgan International and former Manager, BIS; Howard Davies, former Chairman, FSA (UK); Edward George, former Governor, Bank of England; Masamato Yashiro, former President, Shinsei Bank.

[6] This loan accounting required banks to classify loans as Normal, Special Mention, Substandard, Doubtful, and Loss (in declining order of quality). See Walter (2008).

[7] See Liu Mingkang, "Setting A New Stage in China's Banking Supervision and Regulation", 11 March 2004; Brehm and Macht (2004: 316-317).

[8] The Chinese SOCBs listed on the Hong Kong Stock Exchange are already subject to local disclosure requirements. Hong Kong's Monetary Authority required all local banks to comply with Basle II (with the A-IRB approach optional) from 1 January 2007, but it did not require the SOCBs to do so.

[9] Author interviews, Beijing and London, October 2008.

[10] The following section is based on author interviews, Beijing, London, and Washington DC, September 2008 to April 2009.

[11] Author interview, Beijing, September 2008.

[12] Author interview, Beijing, September 2008.

[13] Calculated from the Barth, Caprio, and Levine banking regulation and supervision survey, http://go.worldbank.org/SNUSW978P0, accessed 7 May 2008.

[14] In addition to the SOCBs, there are listed joint stock banks which accounted for nearly 14% of total banking sector assets by the end of 2007. Foreign banks controlled only 2.4% of total assets (CBRC 2007: 139). The joint stock banks are mainly owned by local governments and SOEs. Thus, compared to most countries, foreign ownership is relatively low in China and state ownership very high.

[15] The SOCBs have also benefited from the PBC's heavy reliance on the use of reserve requirements as a tool of monetary policy, because these banks are highly liquid but prefer not to lend to competitor joint stock banks through the interbank market (author interviews, Washington DC, April 2009).

[16] Interviews, Beijing, September 2008. On Chinese bank membership of the IIF, see (IIF 2009: 49).

[17] "China's New Lending Surges, Fueling Bad-Loan Concerns", *Bloomberg*, July 8, 2009.

[18] "China's banks lend with communist zeal", *FT.com*, July 8, 2009.

[19] Author interviews, Beijing, September 2008.