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Do Voluntary Standards Work Among Governments? The Experience of International Financial Standards in East Asia

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Can there be a worldwide ‘race to the top’ in financial regulatory practices? The G7 countries and the international financial institutions (IFIs) would seem to assume so. In recent years, they have actively promoted the adoption of a set of voluntary international standards and codes on the grounds that worldwide convergence on ‘best practice’ in macroeconomic policy and regulation is both possible and desirable. The Financial Stability Forum (FSF), established in the wake of the emerging market crises of the late 1990s, refers to the twelve ‘key standards’ listed on its website as ‘the various economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems’.¹ The FSF, along with the International Monetary Fund (IMF) and the World Bank, has been tasked by the G7 countries with the active promotion of international standards and codes so as to encourage better self-regulation in the major emerging market countries. I term this effort the ‘international standards project’.²

The origin of the international standards project can be found in the major emerging market financial crises of the mid- to late 1990s.

¹ Financial Stability Forum, ‘About the Compendium of Standards’, <http://www.fsforum.org/compendium/about.html>, accessed 15 June 2006.

² In this chapter I am concerned only with international policy standards, not technical product standards. On the latter, see Mattli and Büthe (2003).

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Self-regulatory failures in Mexico and especially in East Asia in the 1990s were interpreted by the major developed countries and the IFIs as the prime cause of these crises. Accordingly, since the establishment of a global financial regulatory agency would be unacceptable to the major developed countries, the focus has been on improving self-regulation in those countries where the perceived regulatory weaknesses are both significant and of the greatest consequence for global financial stability.

The question that arises is whether this approach to improve self-regulation in the major emerging market countries is likely to succeed. In this chapter, I argue that the East Asian experience since 1997 suggests that the international standards project suffers from some major shortcomings. First, the project makes optimistic assumptions about the strength of the two main international mechanisms promoting compliance: the IFIs and the private financial markets. The weakness of these mechanisms means that compliance remains largely a matter of domestic politics. Second, domestic politics in a number of developing countries often favor what I term 'mock compliance' strategies, where governments adopt international standards formally but in ways that limit their impact on the private sector. Third, compliance failures have varying effects on financial stability. Poor compliance can be associated with bad regulatory outcomes, but sometimes noncompliance is the best option.

I focus on East Asia for three main reasons. First, East Asian countries were a particular focus of the international standards project because of the dominant view that inadequate financial regulation and supervision was the main cause of the deep crisis in Japan and subsequently in other East Asian economies. Second, after the 1997–8 crisis, most Asian governments pledged to improve self-regulation by adopting international standards. Third, as I argue later, there are considerable differences within East Asia relating to the degree of compliance with international standards. Exploring these differences can help illuminate the causes of failure and success in compliance in general.

The rest of this chapter is organized as follows. Section 2.1 describes the origins and nature of the international standards project. Section 2.2 presents a theory of compliance, focusing on the determinants of compliance and compliance failure. Section 2.3 considers compliance with a few key international standards in a few East Asian countries since 1997. Section 2.4 discusses the implications of the argument for financial regulatory reform.

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2.1. International Financial Standards and Codes and the Asian Crisis

This section briefly outlines the emergence of international standards in the pre-1997 period before going on to explain the catalytic role of the Asian financial crisis of 1997–8 in the international standards project. Finally, I discuss the presumed roles of the IFIs and private financial markets as international compliance mechanisms.

2.1.1. Origins of the Standards and Codes Exercise

The initial steps toward an international regime for financial regulation began in 1974, with the creation of the Basle Committee on Banking Supervision (BCBS) by the G10 central bank governors under the auspices of the Bank for International Settlements (BIS). In response to the globalization of banking, the BCBS subsequently agreed the Basle Concordat on the sharing of supervisory responsibilities in 1983 and the Basle Capital Adequacy Accord of 1988 (Kapstein 1994; Oatley and Nabors 1998). The key objective was to agree some minimum standards of banking sector supervision and to encourage their adoption in the major developed countries.

Adoption proceeded via the voluntary agreement of bank regulators in the G10 countries, though in practice most developing countries also adopted the Basle Capital Adequacy Accord in the 1990s (Ho 2002). Even though the Accord was a highly flawed product of political compromise among the major countries, its worldwide adoption entrenched the position of the BCBS at the heart of global financial regulatory standard-setting. It also suggested that there were strong incentives for nonsignatory governments to converge voluntarily on standards set by developed country regulators. Less noticed by commentators and academics was that compliance with the Accord was usually not difficult because it was full of loopholes.³

The emergence of the ‘Washington Consensus’ on economic policy in the early 1990s also signaled a growing confidence in the appropriateness of Western economic policy models for developing countries. In late 1994 and early 1995, this confidence was reflected in the Western response to the Mexican peso crisis. Although the crisis of this star

³ As I explain in Section 2.3, Oatley and Nabors (1998) and Ho (2002) are among those who overlook the various loopholes that limited the practical impact of the Accord’s adoption in both developed and developing countries.

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pupil of Latin American economic reform prompted a heated debate about the virtues of capital account liberalization, the G7 governments emphasized the failure of the Mexican government to provide timely and reliable macroeconomic data to the markets in the lead-up to the crisis. 'Transparency' became the new mantra.⁴ If countries like Mexico wished to participate in international financial markets, it was concluded, they needed to adopt Western standards of policy and data transparency.

The G7 assigned the IMF to take the lead in establishing benchmarks for the public provision of timely and reliable data. This led to the creation and promulgation of the Specific Data Dissemination Standard (SDDS) and the General Data Dissemination Standard (GDDS) in March 1996 and December 1997, respectively. The SDDS was specifically designed 'to guide countries seeking access to international capital markets in the dissemination of economic and financial data to the public'. Within little more than two years, however, it became clear that transparency by itself would not solve the problem.

2.1.2. *The Impact of the Asian Crisis*

When much of East Asia succumbed to financial crisis only a few years after Mexico, the international financial reform debate was reignited and ranged more broadly than at any time since the Bretton Woods conference of 1944. Although there were different interpretations of the Asian crisis, the one that most appealed in IFI and G7 circles blamed poor domestic regulation in Asia, exacerbated by cronyism and corruption, for creating moral hazard in the financial and corporate sectors (Corsetti et al. 1998; Krugman 1998).⁵ The American, British, and German governments in particular favored this interpretation of the crisis, while Japan, dealing with an intensifying domestic financial crisis at home, was in no position to oppose it.

The view that the Asian crisis was primarily due to domestic regulatory failures played an important role in the design of the structural reforms contained in the IMF-led rescue packages (Blustein 2001; IEO 2003). It also

⁴ See the background paper issued before the Halifax G-7 summit of June 1995, which included a section on 'promoting financial stability in a globalized economy', available at <http://www.library.utoronto.ca/g7/summit/1995halifax/financial/5.html>, accessed 4 February 2004.

⁵ An alternative view gave more weight to poorly regulated and volatile international capital flows (Radelet and Sachs 1998; Wade and Veneroso 1998).

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prompted a renewed effort by the G-7 and the IFIs to set and promulgate new international standards and codes that could serve as benchmarks for regulatory upgrading in developing countries. Michel Camdessus, then IMF Managing Director, mapped out the path in a speech in March 1998: '[T]here is broad consensus on what needs to be done to strengthen financial systems—improve supervision and prudential standards, ensure that banks meet capital requirements, provide for bad loans, limit connected lending, publish informative financial information, and ensure that insolvent institutions are dealt with promptly.'⁶ With the Basle Accord and SDDS as precedents, the G-7 finance ministers argued that the promotion of global financial stability required both sound macroeconomic and sustainable exchange rate policies and 'the adoption and implementation of internationally-agreed standards and rules in these and other areas' (G-7 Finance Ministers 1999).

The twelve 'key standards for sound financial systems' are summarized in Table 2.1. They include financial regulatory standards (e.g. banking, securities, and insurance regulation), 'market infrastructure' standards (e.g. accounting and corporate governance), and policy and data transparency standards (e.g. fiscal policy, monetary policy, and data transparency). Note that these international standards have no legally binding status and have no formal international compliance mechanism attached to them (Jordan and Majnone 2002: 15). Generally, according to the FSF, standards 'set out what are widely accepted as good principles, practices, or guidelines in a given [policy] area'.⁷

There are a number of things to note about this list. First, it reflects how core aspects of domestic economic regulation and governance have become matters of international concern and negotiation. Second, all of the standards are of relatively recent origin, many postdate the onset of the Asian crisis in July 1997, and upgrading is a continuous process. Third, a wide range of international institutions is responsible for standard-setting, including the major IFIs and other more specialized standard-setting bodies (some of which are private-sector organizations). Fourth, each of the twelve key standards contains further codes and principles, though these often take a fairly general form. By January 2001, in effect, the standards compendium maintained by the FSF comprised

⁶ Michel Camdessus, remarks at the IMF Seminar on Capital Account Liberalization, Washington, DC, March 9, 1998, available at: <http://www.imf.org/external/np/speeches/1998/030998.htm>, accessed August 14, 2003.

⁷ FSF, 'What are Standards?', http://www.fsforum.org/compendium/what_are_standards.html, accessed April 22, 2003.

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Table 2.1. Key international standards and codes

Year of adoption or revision	Standard-setter	Standard or code and official objective
<i>Macroeconomic policy and data transparency standards</i>		
1996–7	IMF	Special Data Dissemination Standard (SDDS), General Data Dissemination Standard (GDDS): The SDDS serves to guide countries that have, or that might seek, access to international capital markets in the dissemination of comprehensive, timely, accessible and reliable economic, financial and socio-demographic data to the public. The GDDS serves to guide any member countries in the provision to the public of such data.
1998	IMF	Code of good practices on fiscal transparency: contains transparency requirements to provide assurances to the public and to capital markets that a sufficiently complete picture of the structure and finances of government is available so as to allow the soundness of fiscal policy to be reliably assessed.
1999	IMF	Code of good practices on transparency in monetary and financial policies: identifies desirable transparency practices for central banks in their conduct of monetary policy and for central banks and other financial agencies in their conduct of financial policies.
<i>Institutional and market infrastructure standards</i>		
1990–2002	FATF	The forty recommendations of the financial action task force on money laundering: set out the basic framework for effective anti-money laundering policies. Special recommendations on terrorist financing: set out the basic framework to detect, prevent, and suppress the financing of terrorism and terrorist acts.
1999–2004	OECD	Principles of corporate governance: aimed at improving the legal, institutional, and regulatory framework for corporate governance in OECD and non-OECD countries.
2001	CPSS/IOSCO	Core Principles for Systemically Important Payment Systems (CPSIPS), Recommendations for Securities Settlement Systems (RSSS): CPSIPS sets out core principles for the design and operation of systemically important payment systems. RSSS identifies minimum requirements that securities settlement systems should meet and the best practices that systems should strive for.
2002	IASB	International accounting standards: set out principles to be observed in the preparation of financial statements. A total of 41 standards have been issued as of July 2003; updating is ongoing.
2002	IFAC	International standards on auditing: ISAs contain basic principles of auditing and essential procedures together with related guidance in the form of explanatory and other material.
2001 draft, not yet agreed	World Bank	Principles and guidelines for effective insolvency and creditor rights: intended to help countries develop effective insolvency and creditor rights systems.

(cont.)

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Table 2.1. (Continued)

Year of adoption or revision	Standard-setter	Standard or code and official objective
<i>Financial regulation and supervision</i>		
1997–2000	IAIS	Insurance core principles: comprise essential principles designed to contribute to effective insurance supervision that promotes financial stability.
1998	IOSCO	Objectives and principles of securities regulation: designed to help governments to establish effective systems to regulate securities markets and to promote investor confidence.
1999	BCBS	Core principles for effective banking supervision: intended to serve as a basic reference for bank supervisory and other public authorities in all countries and internationally. The 25 basic principles are considered essential for any bank supervisory system to be effective.

Sources: IMF and FSF websites.

in total seventy-one specific standards. Finally, many of the standards are interdependent (e.g. accounting, auditing, and corporate governance standards).

The Basle Committee's twenty-five Core Principles for Effective Banking Supervision (hereafter 'Core Principles'), issued in September 1997, are one of the most important key standards (Table 2.2). Along with the Corporate Governance Principles (CGP) and International Accounting Standards (IAS)⁸, these constitute a central pillar of financial sector regulation and prudential supervision. The first Basle Core Principle, the 'precondition' for effective supervision, advocates what is by now G-10 conventional wisdom: political independence for financial regulators, a clear set of responsibilities and objectives, the power to enforce compliance, legal protection for supervisors, sufficient financial resources, and so on. The discussion on principles 2 and 3 suggests that 'clear and objective criteria...reduce the potential for political interference in the [bank] licensing approach' (BCBS 1997: 15–16). Generally, '[t]he Principles are minimum requirements...intended to serve as a basic reference for supervisory authorities in all countries and internationally' (BCBS 1997: 2).

⁸ Strictly speaking, since 2001 the International Accounting Standards Board (IASB) issues International Financial Reporting Standards (IFRS), but existing IAS remain valid until replaced or withdrawn. In what follows, I refer simply to 'IAS'.

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Table 2.2. Summary of BCBS core principles for effective banking supervision (September 1997)

1. Supervisory framework
2. Permissible activities of banks
3. Bank licensing criteria
4. Ownership review powers
5. Investment review powers
6. Minimum capital requirements for banks
7. Bank credit policies
8. Loan evaluation, provisions
9. Large exposure rules
10. Connected lending rules
11. Country risk rules
12. Market risk rules
13. Other material risk rules
14. Internal control systems
15. Preventing fraud
16. Onsite/offsite supervision
17. Contact with management
18. Offsite supervision rules
19. Mechanisms for independent validation of information
20. Consolidated supervision
21. Accounting/disclosure
22. Remedial measures/exit
23. Global consolidation
24. Host country supervision
25. Supervising foreign banks

Sources: BCBS, www.bis.org

Behind this general prescription lay a new ideal type of what may be called ‘regulatory neoliberalism’: the idea that independent regulatory agencies should apply stringent rules in a fairly nondiscretionary fashion in a deregulated financial marketplace. The subtext is fairly clear: excessive state intervention of a discretionary kind, as in many East Asian countries prior to the crisis, creates problems of moral hazard and chronic regulatory failure. Hence, the adoption of Western-style standards would help to eradicate such self-regulatory failures and promote both domestic and international financial stability (Mishkin 2001).

2.1.3. External Compliance Mechanisms

All of the international institutions involved in the international standards project recognize that promulgation is one thing and compliance is another. There is an explicit emphasis in the official literature on two interdependent, external compliance mechanisms: market and official incentives. Market incentives would be promoted by educating market

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actors about the various international standards and encouraging them to take them into account in assessing international portfolio risk (FSF 2000: 4). Essentially, markets would encourage compliance by raising the cost of finance for sovereign or private sector borrowers in noncompliant countries. The operation of market pressure was also seen as dependent on the provision of credible and timely information about the level of country observance of various standards. Here, the IFIs were to play a key role by assessing compliance in an objective manner and making this information available to market actors.

The assessment of country compliance with standards and codes has been part of the IMF's Article IV policy surveillance role since May 1999. The IMF executive board has also included observance of standards among factors taken into consideration in committing financing to a country under the Contingent Credit Line (CCL) facility.⁹ As noted earlier, the upgrading of financial regulatory, accounting, and corporate governance standards were also prominent aspects of the IFIs' conditionality packages in Asia and elsewhere in the late 1990s. Most importantly, the joint IMF–World Bank Financial Sector Assessment Programme (FSAP) is designed to assess country compliance with international standards, though on a voluntary basis.¹⁰ Reports on standards observance are prepared for the executive boards of the IFIs and may be published in the form of Reports on the Observance of Standards and Codes (ROSCs). Despite their voluntary nature, as of the end of April 2005, 592 initial assessments of standards observance and 131 updates had been completed in 122 countries, constituting two-thirds of the IMF membership (IMF and World Bank 2005: 14). The rate of ROSC publication is about 75 percent to date.

Official incentives for standards compliance would work through two main mechanisms. The first was by promoting a dialogue between the IFIs, their executive boards, and member countries. There have been considerable efforts by the IFIs to raise awareness of the importance of better self-regulation in member-states, and the IMF in particular has invested significant new resources in this area. Second, by encouraging the publication of ROSC modules, IFI assessments could be expected to bolster market pressure on governments to comply by raising the financial costs of nonobservance.

⁹ Particularly SDDS, the Codes on Fiscal Transparency, on Transparency in Monetary and Financial Policies and the Basle Core Principles (Clark 2000: 168, fn.20).

¹⁰ The US Treasury has argued for mandatory participation (US GAO 2003: 65), though the USA itself has published only one ROSC, on fiscal transparency.

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2.2. Compliance in Theory

Should we expect that market and official compliance mechanisms outlined above to operate effectively? In Section 2.2.1, I outline how we should understand compliance, the effect of compliance costs and ease of third-party monitoring on compliance outcomes.

2.2.1. *What Is Compliance?*

Some authors assume that once international standards are promulgated, the external market and official pressures for compliance outlined above will be sufficiently powerful to ensure compliance (e.g. Soederberg 2003). I argue below that this view is mistaken and that a significant gap between 'implementation' and 'compliance' is likely to arise in particular cases.

Compliance is a more comprehensive concept than 'implementation'. Implementation occurs when state legislatures and agencies take the necessary steps to ensure that official policies and regulations are consistent with international standards. Compliance occurs when countries' actual behavior conforms to the prescriptions of a specific rule or standard.¹¹ Thus, a gap may arise between implementation and compliance if individual actors in the public and/or private sector behave in ways inconsistent with implemented regulations and if domestic enforcement is weak. Compliance could also conceivably occur in the absence of formal implementation, though often a failure by a government to adopt or implement international standards in the first place will derive from domestic resistance to compliance.

Note in this regard that although the burden of implementation falls primarily on the state and its agencies, the burden of compliance often falls on both the public and the private sector. Although some international standards only constrain aspects of public sector behavior (e.g. SDDS), other international standards can imply considerable costs for private sector actors. This applies to most standards relevant to financial regulation, including IAS, corporate governance, and banking supervision standards. Thus, for example, if a country adopts IAS for domestic financial reporting by listed companies, the level of country compliance is likely to be affected by the expected costs incurred

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¹¹ Compliance is a 'state of conformity between an actor's behavior and a specified rule' (Raustiala and Slaughter 2002: 539). This definition owes much to Young (1979: 3). See also Shelton (2003: 5).

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by companies who must change their methods and degree of financial disclosure and the costs they can expect to incur in the event of noncompliance.

There is no reason to believe that compliance failures will only occur when private sector actors fail to conform to (implemented) international standards. 'Regulatory forbearance' also occurs when the government or its agencies intentionally refrain from strictly enforcing adopted regulations, systematically or on an ad hoc basis. As in the classic 'time-inconsistency' problem in monetary policy, it may be optimal for the government to commit itself to the adoption of international standards and subsequently to engage in regulatory forbearance (e.g. because the strict application of new prudential rules could lead to a contraction of private sector credit). Regulatory forbearance includes allowing technically insolvent banks to continue operating, temporary relaxations or nonapplication of rules relating to bad loan accounting or provisioning, turning a blind eye to violations of exposure rules, rapid deregulation of new lines of business to allow banks to build profits, and so on (Honohan and Klingebiel 2000: 7).

In addition, compliance failure may occur because of low bureaucratic capacity or corruption, both of which limit the effectiveness of oversight and enforcement. Highly independent and powerful agencies may also obstruct compliance. By strictly applying regulations that force bank failures, for example, regulators may leave themselves open to accusations of past negligence or incompetence.¹²

2.2.2. *Compliance Costs and Benefits*

Although the benefits of observance of international standards are often made to sound self-evident, they can raise fundamental economic and political issues for developing countries in particular. In the first place, there is little doubt that representatives from the major Western economies have dominated the standard-setting process in most cases. The perception that they are not just Western but Anglo-Saxon in origin is strong in developing countries, potentially creating what the IMF likes

¹² Such considerations may have played a part in the 1980s decision of the US regulator of savings and loan (S&L) institutions, the Federal Savings and Loans Insurance Corporation (FLSIC), to engage in regulatory forbearance (Jackson and Lodge 2000: 109).

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to refer to as 'ownership problems'.¹³ This perception of limited legitimacy and the consequent politicization of international standard-setting significantly lessen the likelihood of 'norm-driven' compliance, as does the often substantial gap between international and existing domestic standards.¹⁴

Rather than focus on this legitimacy question here, I consider compliance from a simple cost-benefit perspective. Considering compliance costs first, there are potentially significant distributional asymmetries at both the international and domestic levels. In the case where international standards are more stringent than existing domestic standards, this implies potentially significant compliance costs for public and private sector actors. Compliance costs are therefore generally higher for developing countries than the developed countries who dominate international standard-setting. As for domestic compliance costs, these tend to be concentrated on particular sectors or societal groups (e.g. banking regulatory standards raise costs for the banking sector, IAS raise costs for the business sector generally, etc.). They also tend to be the highest in the short run: the one-off costs of adjusting to higher standards tend to be greater than the ongoing costs of compliance.¹⁵

Compliance benefits may be potentially high for countries whose domestic standards are lax compared to international standards (the key benefit, presumably, is greater financial stability). However, compared to compliance costs, benefits of these kinds tend to be both uncertain and long term in nature. Moreover, while compliance costs tend to be concentrated on businesses or particular business sectors, compliance benefits tend to be much more widely spread across society. Indeed, the main supposed benefit of adopting international standards, greater financial and economic stability, has public good characteristics.

The nature of compliance costs and benefits and their distribution makes standards compliance rather like trade liberalization, and quite different from technical standards. Technical standards often exhibit strong market incentives for compliance because of high network externalities

¹³ Arguments of this kind were made by Asian representatives at the first Asia-Pacific meeting of the FSF in October 2001 (FSF Press Release, 'First Asia-Pacific Regional Meeting of the FSF', Ref. No. 32/2001E, October 19, 2001).

¹⁴ For a discussion of these and other factors that hinder norm-driven compliance, see Checkel (2001) and Underdal (1999).

¹⁵ Think, for example, of the initial costs incurred by European firms in adjusting to the recent adoption of IAS in Europe, or to the new listing and corporate governance requirements in the USA.

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(i.e. the benefits of compliance increase as more actors adhere to the standard). By contrast, those sectors that bear most of the immediate costs of compliance with policy standards are likely to oppose compliance, whereas the potential beneficiaries will have comparatively little incentive to lobby strongly for their adoption. As a result, when existing domestic standards are inferior to international standards and compliance costs for the private sector are substantial, governments are not likely to favor compliance.

As an empirical matter, private sector compliance costs in East Asia varied substantially across international standards areas. They were especially high for IAS, corporate governance standards and financial sector regulation standards, since existing domestic standards in these areas were poor in most Asian countries in 1997. Adopting international standards in these areas was especially costly for the family- and state-owned banks and companies which predominate in Asia (Claessens et al. 1999; Capulong et al. 2000: vol. 1, 23–8). Low levels of bank capitalization, poor corporate profitability, and the predominance of relationship lending meant that higher prudential and disclosure standards would be especially costly for banks and for their customers. This was especially true after the crisis, when the private sector in the crisis-hit Asian countries was in a highly distressed situation. By contrast, private sector compliance costs were low for other standards such as SDDS and the other macroeconomic transparency standards, though adherence to these international standards could potentially reduce both public and private borrowing costs.¹⁶ We would therefore expect levels of Asian compliance to be greater for these standards than for prudential, corporate governance, and financial disclosure standards.

2.2.3. *Monitoring, International Pressure, and Compliance*

This conclusion might be questioned for the following reason. Even if the private sector is largely opposed to compliance with certain international standards, international actors may still place considerable pressure on both governments and the private sector to comply. As we have seen, the international standards project has explicitly cited both the IFIs and international financial markets as important external compliance mechanisms. However, I wish to argue that these two mechanisms are likely

¹⁶ For example, if SDDS adherence reduces the sovereign borrowing rate, this could reduce the average private sector borrowing rate, since the former is usually a floor for the latter.

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to be weak in precisely those areas where the domestic-level compliance incentives discussed above are also weak.

Let us assume that the external pressure on countries to adopt international standards is indeed strong, but that governments and the domestic private sector believe that it will be difficult for third parties to monitor the true level of compliance and/or to punish noncompliance. In this situation, the government may decide that its best option is to adopt international standards but to engage in 'mock compliance', or formal adoption or implementation without substantive compliance. The government may believe that by doing so it will obtain at least some of the benefits of compliance (or at a minimum, avoid the costs of explicit noncompliance),¹⁷ while the domestic private sector may be reassured that they will not bear large real compliance costs in practice. Although well-capitalized and strongly managed banks and companies may prefer the gap between formal and substantive compliance to be relatively small, weak banks and firms threatened with their very survival have stronger incentives to lobby for mock compliance. The government also has stronger short-term incentives to be concerned about business failures.

The difficulty of third-party monitoring of compliance, and hence the applicability of this argument, will vary by international standard. In the case of the SDDS, for example, monitoring is relatively straightforward. Whether countries meet the SDDS requirements is publicly disclosed in a simple yes–no manner on the IMF's Dissemination Standards Bulletin Board (DSBB). Although the IMF does not monitor in depth the quality of the data placed by the country authorities on the DSBB, cross-checks embedded in the format and considerations of reputation both pose constraints on fraudulent postings. By comparison, monitoring the quality of compliance with the Basle Core Principles, CGP, or IAS is very difficult and costly for third parties, requiring considerable research and qualitative judgment. To take one obvious but typical example, a government may say that its domestic accounting standards 'approximate' IAS. Estimating the importance of any divergences between domestic and international standards in such cases is difficult enough. Even when governments claim that all listed companies must report using IAS (which is the case today

¹⁷ The costs of explicit noncompliance by one country are likely to increase if most of its peers adopt international standards. Of course, if third parties have imperfect information concerning governments' true compliance intentions, the credibility of any government's commitment to compliance will be low (Rodrik 1989: 757). As a result, some potential benefits such as lower borrowing costs may not be forthcoming. However, governments with weak compliance intentions may calculate that they have little to lose from formal compliance and the potential to achieve other benefits, such as cooperation with the IMF.

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for about half of all countries),¹⁸ assessment of the quality of compliance requires in-depth analysis of auditing processes, stock market organization, and the strength of legal enforcement among other things.

Some might argue that the IFIs themselves perform this task through the FSAP process. However, this process has major shortcomings from the point of view of market participants. As noted earlier, country participation in the FSAP is voluntary, as is publication of ROSCs. Even when published, sensitive information is removed, usually including any quantitative assessments that might be more easily digested by market actors. Furthermore, given the resource-intensive nature of the FSAP process, updates are infrequent. Unsurprisingly, private sector analysts routinely respond that ROSCs are 'untimely, outdated, and too dense to be useful' (US GAO 2003: 22).

The considerable difficulties encountered in assessing compliance are one reason why the IFIs and market actors tend to be weak at enforcing compliance, but there are other reasons. Even if the IFIs have explicit knowledge of poor quality compliance in a particular case, they may be reluctant to make this known so as to avoid precipitating a market reaction or to maintain a good working relationship with the government. In practice, market participants have little faith in the willingness of the IFIs to 'blow the whistle' on countries that fail to observe core standards (FSF 2000: 20–31).

There are also reasons to believe that markets will not consistently punish poor compliers. If we assume investors will be concerned primarily with financial returns, a particular company's compliance with international standards will only be relevant to the investment decision if such compliance affects risk-adjusted profitability. Although better financial disclosure and higher corporate governance standards might sometimes be important to investors, strong market positions, and political connections might be more important in emerging markets.¹⁹ In practice, such 'pull' factors that apply to particular companies and markets tend to be swamped by aggregate 'push' factors like the level of liquidity in developed country financial markets. Push factors are the dominant determinants of equity inflows into emerging market countries (Maxfield 1998; IMF 2001: 40–1). Indeed, emerging market countries and firms with

¹⁸ Deloitte provides information on national accounting requirements for 143 countries, of which 72 required IAS reporting for all listed companies as of March 26, 2006 (<http://www.iasplus.com/country/useias.htm>, accessed June 19, 2006).

¹⁹ One bank respondent to an FSF survey said that if it were to require strict observance of IAS in its business in developing countries, up to 25 percent of this business would be lost (FSF 2000: 23–4).

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better quality corporate governance have tended to *under*-perform those with poorer quality corporate governance when international liquidity is flowing into these countries, as in recent years (CLSA Emerging Markets 2005: 4). Unsurprisingly, few companies have felt a need to undertake independent and transparent assessments of the quality of their corporate governance.²⁰

It may be said that banks, which are especially dependent on reputation for their viability, should be subject to considerable market compliance pressure. Again, however, formal compliance with international standards such as the Basle capital adequacy minima may be all that is necessary. Although sophisticated creditors understand that banks' capital adequacy ratios (CARs) are easily manipulated and are a poor measure of true financial strength, formal compliance by banks seems to be all that is necessary. This is because such creditors take into account that national authorities usually effectively guarantee the liabilities of formally compliant banks (Moody's Investor Services 1999; Fitch Ratings 2003a). In other words, too-big-to-fail assumptions can short-circuit market pressure for substantive compliance with international standards.

To summarize, the argument suggests that compliance strategies are driven by domestic political factors instead of by external compliance pressures, which we suggest will often be weak. In particular, we expect that mock compliance strategies will be more likely when private sector compliance costs *and* when third-party compliance monitoring costs are both relatively high. This is illustrated by quadrant 4 in Figure 2.1. The following section considers whether this prediction is consistent with the evidence.

2.3. Compliance in Practice

In what follows I briefly assess the prediction of Section 2.2 in two ways. First, I compare compliance with SDDS (where private sector compliance costs and monitoring costs are low) and IAS (where both costs are high) globally and in East Asia. Second, I assess compliance across East Asian countries in one key standard of the Basle Core Principles for which

²⁰ Standard & Poor's, the credit ratings agency, announced in 2002 that it would offer corporate governance ratings based on the OECD Principles for companies to complement their credit ratings (Standard & Poor's 2002). However, as of February 6, 2005, only twenty-five companies had been rated, fourteen of which were from Russia.

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		Compliance costs	
		Low	High
Monitoring costs	Low	1 SDDS, GDDS	2
	High	3 Macroeconomic transparency standards	4 Prudential regulation, corporate governance standards, IAS, money laundering standards

Figure 2.1. Private sector compliance costs and third-party monitoring costs

private (and public) sector compliance costs and third-party monitoring costs are relatively high: the Basle capital adequacy regime.

2.3.1. *SDDS vs. IAS*

Table 2.3 compares rates of compliance with SDDS to rates of adoption of IAS or US Generally Accepted Accounting Principle (GAAP) across different country categories.²¹ It shows that on average, at the end of 2003 SDDS compliance among IMF members was 29 percent. This was similar to the percentage of countries that had adopted IAS or US GAAP in full, though lower than the 59 percent of countries that at that time required or allowed at least some firms to report using these international standards. Compliance with SDDS, as one would expect, is much higher for the major emerging market countries on JP Morgan's EMBIG database, but the adoption of IAS is much lower for this group (58% vs. 29%). It is even higher for those countries hit by systemic banking crises in recent years. Of eighteen major banking crisis countries over

²¹ For sources and definitions, see Table 2.3. The IAS/US GAAP calculations are made using data for those countries for which information is available, which probably biases the estimates upward. I use US GAAP (Generally Accepted Accounting Principles) and IAS as joint benchmarks for international accounting standards because of the unresolved competition between them for international standards status.

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Table 2.3. Compliance with SDDS and adoption of IAS/US GAAP, end 2003

	SDDS	IFRS/US GAAP (full adoption)	IFRS/US GAAP (including partial definition)
% of IMF members/known countries: IFRS	29	30	59
% of emerging market countries (EMBIG)	58	29	50
% of countries with banking crises within past 5 yrs	47	22	47
% of 58 crisis-hit countries (past 10 yrs)	50	29	53
% of 18 major crisis-hit countries (past 10 yrs)	78	6	22
% of 10 major East Asian economies	80	0	20

Notes: SDDS compliance is measured by whether a country is deemed by the IMF to have met SDDS specifications. Banking crises are defined as 'systemic' (Caprio and Klingebiel 2003). The 18 major banking crisis countries are Argentina, Brazil, China, the Czech Republic, Egypt, Hungary, India, Indonesia, Japan, Korea, Malaysia, Mexico, the Philippines, Poland, Russia, Thailand, Turkey, and Venezuela. Emerging market countries are those on the JP Morgan Emerging Market Bond Index Global (EMBIG). The 10 major East Asian economies are China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand.

Sources: Street (2002); IAS Plus website (<http://www.iasplus.com/country/country.htm>), SDDS website (<http://dsbb.imf.org/Applications/web/sddshome>), and Caprio and Klingebiel (2003).

the past decade, 78 percent are SDDS subscribers. Levels of SDDS compliance by major East Asian countries are higher: eight of the possible nine are subscribers (Taiwan is not an IMF member; China was the only nonsubscriber).

Table 2.4 shows that the major crisis-hit East Asian countries were relatively early subscribers to SDDS, only slightly behind the G-7 average, though they took longer than most countries to meet in full the various SDDS specifications. Note, however, that Korea complied with SDDS much more quickly than the G-7 average and that the average time to compliance for all countries is low because since 2001, new SDDS subscribers have tended to collapse all three stages of SDDS compliance into one. By contrast, few major crisis-hit countries adopted IAS/US GAAP (only one of eighteen did so in full); none of the major East Asian economies did so.

Table 2.3 gives a misleading picture of the extent of *compliance* with IAS in two ways. First, it ignores the fact that most countries in East Asia have revised domestic accounting standards in recent years and brought them closer to international standards. Second, it only shows formal adoption rates, not true compliance. Estimating the latter is very difficult. It was clear in 2002–3 that important areas of divergence between national and IAS remained in most cases in East Asia, though this is difficult even for experts to assess.²² Moreover, few believe the quality of financial reporting

²² For example: see the country assessments in Nobes (2001).

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Table 2.4. SDDS subscription, posting and compliance dates, selected countries, and groups

	Date of subscription (1)	Date metadata were posted on the DSBB (2)	Date when subscriber met SDDS specifications (3)	3-1 (days)	3-2 (days)
Average all countries	April 20, 1998	October 2, 1998	March 30, 2001	1,060	897
G7 average	July 5, 1996	November 19, 1996	January 3, 2000	1,258	1,124
Indonesia	September 24, 1996	May 21, 1997	June 2, 2000	1,328	1,091
Korea	September 20, 1996	March 30, 1998	November 1, 1999	1,121	571
Malaysia	August 21, 1996	September 19, 1996	September 1, 2000	1,450	1,422
Singapore	August 1, 1996	September 19, 1996	January 30, 2001	1,619	1,571
Thailand	August 9, 1996	September 19, 1996	May 16, 2000	1,357	1,317

Note: The average figure is for all 61 SDDS subscribers as of June 22, 2005.

Sources: IMF, DSBB: <http://dsbb.imf.org/Applications/web/sddssubscriptiondates/>, accessed June 22, 2005.

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in most of East Asia to be on a par with that, say, in the USA and UK. Comparable measures of the quality of accounting and auditing are hard to find, but survey measures of the quality of national accounting regimes generally show that East Asian countries except Singapore and Hong Kong substantially lag the G-7 average.²³ Most Asian countries adopted a strategy of moving only toward allowing IAS reporting for some companies (usually those that are foreign-listed and for whom compliance costs are low), while more incrementally modifying national accounting standards for the rest. On balance, then, it is reasonable to conclude that the quality of compliance with SDDS is probably considerably greater in East Asia than is compliance with IAS. This is consistent with the prediction made in Section 2.2.

2.3.2. *Basle CARs*

By comparison with SDDS and even IAS, assessing the degree of country compliance with the Basle Core Principles is very difficult. Published FSSAs and ROSCs, as already noted, are in very short supply: only Hong Kong, Korea, Japan, and Singapore have undertaken FSAPs and published banking ROSCs, despite considerable international pressure on the others to do so (US GAO 2003: 19). These reports are also qualitative, difficult to compare across countries, and often pull punches, though the Japanese assessment is, unusually, sharply critical in places. For this reason and because of space considerations, I simplify the task in this section by considering only East Asian convergence on the Basle capital adequacy provisions. Is there evidence that the quality of compliance is poor in this area, as predicted above?

In terms of formal adoption, fully 90 percent of all countries surveyed by the World Bank have signaled that they had adopted the Basle capital adequacy regime by 2001, which requires internationally active banks to have a minimum 8 percent risk weighted capital ratio (Barth, Caprio, and Levine 2002). This is a much higher formal adoption figure than for any other international standard discussed here. Furthermore, as Table 2.5 shows, official Basle CARs in the major Asian crisis-hit developing countries were considerably in excess of the 8 percent Basle minimum. In many cases, average Asian bank CARs were above those in the USA by early 2003.

Au: World Economic Forum survey (2003) is not listed. Pl. check.

²³ See, for example, the World Economic Forum survey (2003: 610).

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Table 2.5. Basle CARs in selected Asian countries and the USA, 2003

Country	Official average capital adequacy ratios, mid-2003 (%)	Moody's bank financial strength ratings, March 2003
Hong Kong	15.6	C+
Indonesia	21.4	E
Japan	10.8	D–
Korea	10.4	D–
Malaysia	13.4	D+
Singapore	17.8	B
Thailand	13.6	D–
USA	12.7	B

Notes: CARs are unweighted averages, whereas Moody's BSRF ratings are weighted averages. Moody's BSRF ratings explicitly do not take into account the probability of public sector assistance in the event of potential default. Ratings are from A (the strongest) to E (the weakest).

Sources: IMF, Global Financial Stability Report, April 2004; Moody's, Bank Risk Monitor, March 2003.

To conclude that this reveals over- rather than under-compliance would be wrong, however. There is little doubt that most Asian banks in 2003 had real capitalization levels that were much lower than those of US banks, contrary to the official CARs. The final column of Table 2.5 shows Moody's bank credit risk department's average Bank Financial Strength Rating (BFSR). Moody's BFSRs, in contrast to their standard deposit ratings, are intended as an indication of the 'stand-alone' financial strength of banks. As such, BFSRs explicitly do *not* take into account the probability that the government would rescue a financially distressed bank. It is clear that there is, if anything, an inverse relationship between official CARs and Moody's estimates of the true financial strength of banks.²⁴ Only Singapore's banks have comparable financial strength ratings to the USA, but most of the banks elsewhere in Asia were rated in the two lowest categories of E or D.

There are many reasons why official CARs are not comparable across countries and why they can be wholly misleading as indicators of bank financial strength. The 1988 Basle regime is notoriously weak as regards to rules on loan loss provisions and the components of bank capital, with the result that official ratios often hide a multitude of sins.²⁵ Below, I provide some illustrations of the often poor quality of compliance with

²⁴ Fitch Ratings (2003*b*) finds this inverse relationship holds generally using its own estimates of banks' stand-alone financial strength.

²⁵ For the calculation of Basle CARs, see <http://www.bis.org/publ/bcbs04.htm>, accessed April 11, 2004.

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these standards in postcrisis Asia in three main areas, though these do not exhaust the problems with official CARs.

First, loan accounting standards and practices remained opaque in postcrisis Asia, particularly for 'restructured' nonperforming loans (NPLs), which made up large proportions of bank assets in countries like Indonesia and Thailand. Lax loan accounting has the result of reducing required loan loss provisions, increasing reported profits and inflating official capital. After the crisis, with the encouragement of the IFIs, most countries in the region converged on the standard three-month past due rule for calculating NPLs.²⁶ In Thailand after the crisis, debt classified as 'doubtful' or 'loss' could be reclassified as 'substandard' when a debt restructuring agreement was signed. Substandard or 'special mention' debt would remain within those categories until three months of repayments (or three installments) were fulfilled, after which they could be upgraded to the pass (i.e. accrual) category. This less conservative standard (compared to the USA, which requires six months of repayments) was further relaxed on April 10, 2000, allowing the immediate reclassification of restructured loans to accrual status that satisfied certain criteria. Nor were Thai banks required to report the total amount of such restructured debt in accrual status, though the high levels of 'reentry NPLs' reported by the Bank of Thailand (BOT) suggested that many restructured loans had turned bad again.

Direct evidence of lax loan accounting in Thailand is given by DBS (Singapore) Group's consolidated accounts for 2001 and 2002. This group has a Thai subsidiary, DBS-Thai Danu Bank (TDB). DBS Group is required by Singapore's conservative Monetary Authority to note in these accounts that Thailand's loan classification standards are much laxer than Singapore's, and that if the latter's classification standards were used instead, TDB's NPLs would be about five times higher. Indeed, DBS explicitly noted that according to Thai GAAP, TDB had positive net assets, but that according to Singapore accounting standards it was technically insolvent.²⁷ If this difference is representative of Thai classification standards,

²⁶ The exceptions are Korea, which from 1999 partially instituted a US-style 'forward-looking criteria' (FLC) approach to NPL estimation, and Malaysia, which retains a dual three and six-month standard.

²⁷ DBS Group, *Annual Report (2001)*, p. 126 and *Annual Report (2002)*, p. 80 (Notes to the Consolidated Financial Statements). According to Singapore standards, TDB's NPLs at the end of 2001 were 27.7 percent of total loans, whereas by Thai standards they were merely 5.8 percent (the figures for 2002 were 25.4% and 5.1%, with substandard loans increasing slightly from 2001-2). Furthermore, TDB's level of NPLs increased to 28.8 percent of total loans in December 2003 (available at: <http://www.dbs.com/investor/2003/fy/PerfSummaryFY2003.pdf>, accessed February 25, 2004).

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it implies substantial regulatory forbearance by the BOT and continuing severe weakness in the banking sector.²⁸

A second illustration of poor quality compliance can be found in the regulatory treatment of collateral. Asian banks usually require collateral when lending, particularly property collateral. A large percentage of the value of the collateral attached to NPLs can usually be offset against required provisions. As a result, lax collateral valuation practices can also inflate official CARs. For example, in Thailand, the BOT defined the market value of collateral as 'the probable price on the date of the collateral asset valuation or appraisal *under normal market conditions* with no transaction costs (nor taxes)'.²⁹ According to many analysts, the 'normal market conditions' clause, and the poor quality of valuation firms in Thailand, meant that collateral was often overvalued. Furthermore, in countries like Thailand and Indonesia, where most collateral is in the form of illiquid real estate and where the legal foreclosure regimes were dysfunctional, a best practice (conservative) approach would not allow such netting practices regarding required provisions (Song 2002: 21).

A third area of weakness can be found in the definitions of the allowable components of capital, which vary considerably by country. In Thailand, regulators allowed banks to issue expensive hybrid debt instruments (so-called CAPs and SLIPS) and to include these in Tier I capital, contrary to practice in the USA and elsewhere.³⁰ In Japan, meanwhile, by early 2003 more than half the Tier 1 capital of major banks consisted of deferred tax assets (DTAs), most of which are past tax losses carried forward.³¹ For two of the top seven banks, DTAs made up all of Tier 1 capital (Fitch Ratings 2003c: 17). The Japanese rules on DTAs are lax by almost any standard. In Japan, DTAs may be carried forward for up to five years, as opposed to only one year (or a maximum of 10% of Tier 1 capital) in the USA, the only other major country in which DTAs are important. Since the value of DTAs was often in doubt due to very poor bank profitability, and since

²⁸ Further evidence from another Singapore-owned Thai bank, UOB-Radhanasin Bank, gives a very similar picture to the TDB case (UOB Group, *Annual Report (2001)*, and UOB-Radhanasin Bank monthly reports to BOT, available at: http://www.bot.or.th/bothomepage/databank/financial_institutions/npl_fi/254412/ecb.htm).

²⁹ BOT, 'Regulations for Collateral Valuation and Appraisal', <http://www.bot.or.th/bothomepage/notification/fsupv/2541/thtm/RCVA.DOC>, accessed April 1, 2002. Italics added.

³⁰ Confidential author interviews, regulatory officials, Hong Kong, April 2002, and Thailand, March 2002. In the USA, approved subordinated debt instruments are only allowable as Tier II capital: Comptroller of the Currency (2001: 40).

³¹ DTAs arise due to differences between financial reporting for accounting disclosure and for tax purposes.

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in particular they are not generally available to cushion large losses, there is a strong case for their use as core capital to be sharply constrained (IMF 2003: 8, 18). Their heavy use by Japanese banks cast considerable doubt on the quality of their compliance with the Basle regime. The weakness of internal and external auditors is another factor that allows banks and regulators to collude in regulatory forbearance.³²

Evidence of strong postcrisis pressure on crisis-hit Asian countries to adopt a mock compliance strategy regarding bank capitalization standards is consistent with the theory offered in Section 2.2. The higher quality of compliance witnessed in Hong Kong and Singapore is also supportive. This is not because these countries are rich (cf. Japan) or because they have independent regulatory authorities (neither Singapore nor Hong Kong has). Rather, higher compliance with Basle has been possible for Singapore's and Hong Kong's banks because their economies were much less affected by the crisis, so that the private sector costs of compliance were much lower than in their crisis-hit neighbors. Their banks and other companies are also relatively internationalized and the authorities in both have seen overcompliance as a means of distinguishing themselves from their less compliant neighbors.

In general, then, we can conclude that where the private sector costs of compliance with international standards and third-party monitoring costs are both relatively low, as is the case for SDDS, levels of compliance in East Asia are high. However, where private sector compliance costs and monitoring costs are both high, as is the case with IAS and Basle capitalization standards, the quality of compliance is relatively poor.

That the Asian countries wished to signal their intentions to converge on international standards of this kind despite the difficulty of achieving compliance after 1997 suggests that they were under considerable pressure to do so. The crises that hit Asia demolished the credibility of their previous regulatory frameworks, to the extent they existed, and entrenched the idea that the only viable path to reform was to adopt Western-style financial regulatory standards. At the same time, the economic distress the crises produced made it more difficult to comply in practice with the international standards that received most attention by the IFIs (financial supervision standards, corporate governance standards, and accounting

³² However, the external auditors of Resona, a major Japanese bank, refused in March 2003 to accept the bank's stated value of DTAs, resulting in an overnight collapse of the bank's CAR and a further costly government bailout. Two other major banks also wrote down DTAs in FY2003, though bank analysts believed others should have done the same (Fitch Ratings 2003c: 3).

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standards). The evident reluctance of a number of important East Asian countries (notably China, Indonesia, Malaysia, and Thailand) to submit to the FSAP review process is another indication of this dilemma.

2.4. Implications for Self-Regulatory Reform

What are the implications of the preceding analysis for the reform of self-regulation? We have seen that external compliance mechanisms (IFIs and markets) can promote the reform of domestic regulation after crises. However, governments in crisis-hit countries are also usually subject to stronger domestic pressures to resist substantive compliance with international regulatory standards, leading them to square this circle via mock compliance strategies. The question this raises is whether this outcome is suboptimal and, if so, what should be done about it. The answer, I suggest, is a mixed one.

That there is often considerable domestic flexibility in adopting and adapting international standards is not, on the face of it, a bad thing for two reasons. First, given the legitimacy problems of international standards, retaining some flexibility might be politically important. Second, contrary to the prescriptions of the new ideal type of regulatory neoliberalism, there are occasions on which governments *should* engage in discretionary regulatory forbearance. Though Asian regulators strenuously denied that they were engaged in forbearance in the postcrisis years, there is little doubt that many were. Thailand's relatively lax loan accounting and Tier I capital definitions, Japan's lax loan accounting and regulatory treatment of DTAs, Malaysia's relaxation of bad loan definitions, Indonesia's extraordinarily expensive purchase of bad private sector assets, Korea's encouragement of state-owned banks to lend to a few large firms—all are examples of discretionary interventions aimed at giving breathing space to a highly distressed private sector.³³ Although many Western critics tended to see this as evidence of continuing collusive, 'cronyistic' relationships between East Asian states and their private sectors, such examples might also be seen as pragmatism. This was a pragmatism that, in the new intellectual climate of regulatory neoliberalism, did not dare speak its name.³⁴

³³ For further details, see Walter (forthcoming).

³⁴ The exception is Malaysia, where Prime Minister Mahathir was openly critical of the assumption that it made sense to import more stringent Western financial regulations in the midst of the crisis.

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No doubt in some cases the Western critics of discretionary interventionism in Asian financial regulation are right. However, we should not overlook that the major Western countries, the IFIs and international banks saw the crisis as a once-in-a-lifetime opportunity to fundamentally remodel the relationship between state and market in East Asia. The international standards project was at least as much a deployment of power as the bringing of regulatory 'best practice' to an important part of the developing world. Is it obvious that Japan should have strictly enforced US-style rules in 2002–3, thereby forcing its government to recapitalize, nationalize, or close most of its big banks? (cf. Fitch Ratings 2003c: 2). Western critics of Japan's approach worked themselves up into a frenzy of indignation, but it may be doubted that forbearance is as great a sin as they claimed. Since early 2003, the Japanese banking system has greatly reduced its NPL problem and profits have recovered rapidly, thanks in part to the extraordinary use of DTAs and other time-buying measures.

In retrospect, it might have been simpler and more straightforward for the Asian governments simply to argue that Western standards were inappropriate to the circumstances of the postcrisis period. That they felt unable to do so underlines the effect of the crisis on self-confidence in the region. However, denial of the obvious drained the credibility of governments and regulatory agencies, with serious negative consequences (most notably, perhaps, in Japan).

If the strict application of international standards did not always make sense in the immediate postcrisis period, the question remains whether such standards are appropriate benchmarks for long-term regulatory convergence in Asia and elsewhere. Clearly, the pre-1998 financial regulatory regimes in Indonesia, Korea, Japan, and Thailand all had major failings that contributed to the depth of the crisis these countries suffered in the late 1990s. However, it would be wrong to see international standards as a panacea in all areas. Not only is the international standard-setting process dominated by the major Western countries, but they are the products of domestic politics within these countries. No doubt American bank regulatory, corporate governance, and accounting standards are generally more stringent than those in most developing countries, but as recent scandals have amply demonstrated, US rules are sometimes far from 'best practice'.

Nor is it clear that one size should fit all. In the case of corporate governance standards, the importation of Western rules on board independence has failed to place significant constraints on family owner-managers (Nam and Nam 2004). There is also a difficulty in asking countries to accept a rules-based model of financial regulation and

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supervision when (as in Asia) personal relationships continue to predominate. Institutionally, personal relationships compensated successfully in the past for weaknesses in the institutions that are necessary for arm's-length finance: secure property rights, third-party legal enforcement of contracts, etc. (Yoshitomi et al. 2003: 78). The interdependence of the reforms required by the various standards and codes arguably poses an enormously difficult, complex, and costly transition task for many developing countries. Even in the case of IAS, where the case for a single set of international standards is strong, we need to ask whether the costs of compliance exceed the potential benefit. The sophisticated treatment of financial instruments required by IAS 39, for example, is much less relevant to most firms in developing countries. In general, the appropriate sequencing of institutional reforms remains an open question.

Moreover, as we have seen, regulatory outcomes remain dominated by domestic, economic, and political factors. Setting the standards bar at a fairly high level for developing countries may be the best way of encouraging serious long-term reform, but in the meantime, this approach more or less condemns most countries to a degree of failure. It may also promote a confrontational approach to regulation and supervision that alienates the private sector rather than encouraging them to see better regulation as in their interest.

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