

Concept Paper: The Strategic Implementation of Basel II in Emerging Countries

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Concept Paper: The Strategic Implementation of Basel II in Emerging Countries

This is a concept paper exploring a specific sub-topic of my PhD thesis, and looks at the conflicting goals of Basel II and that of emerging countries, which produces conflicts of interests for implementing authorities. The conflicting objectives of international standards and national authorities are hypothesized to lead to competition-driven or stability-driven implementation strategies for Basel II, which in turn produces implementation gaps between Basel II and actual implementation. Eventually (but not in this paper), I hope to explain the divergent implementation outcomes of Basel II amongst a medium-n size sample of emerging countries.

This paper proceeds in the following 4 steps. In Section 1, I provide a brief overview of Basel II, its objectives and institutional features. In Section 2, I review the global popularity of Basel II and assess a set of compelling reasons why emerging countries may be eager to implement Basel II quickly. However, I also highlight the problems of implementation failures and the implementation gaps between Basel II and actual implementation, which I will attempt to explain. In Section 3, I formulate the research questions and objectives and develop a set of hypothesis to test. Finally, in Section 4, I provide an analytical framework, whereby I first define the independent and dependent variables and assess the plausibility of linking the dependent and independent variables together. Then I (incompletely) define the conflicting objectives of Basel II and domestic political preferences and link them to implementation strategies and outcomes. Before proceeding, the following points are worth noting. This paper addresses the implementation of international standards. Therefore, it does not address the role of emerging economies in the formulation and dissemination of international standards. Also, this research is not an assessment of the effects of international standards on domestic banking sector performance.

Section 1: Basel II

Capital adequacy regulations have been at the centre of national prudential regulations designed to protect the safety and soundness of banks in the past 25 years. It has also been at the heart of efforts towards international regulatory harmonization through an international standards setting process driven primarily by the Basel Committee on Banking Supervision¹. Following the introduction of the Basel Capital Accord in 1988 (Basel 1), virtually all countries with internationally active banks progressively implemented the harmonized international capital adequacy framework. In June 1999, the Basel Committee issued a proposal for a revised

¹ The Committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, UK and US, and not from any emerging countries. Countries are represented by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business where this is not the central bank.

capital adequacy framework. Following extensive interactions with banks, industry groups and supervisory authorities that resembled negotiations for trade agreements, Basel I was extensively revised. In June 2004, the Basel Committee issued the International Convergence of Capital Measurement and Capital Standards: A Revised Framework (commonly referred to as Basel II), leading the way for greater international convergence to supervisory regulations governing the capital adequacy framework of internationally active banks (BCBS, 2006).

Basel II was developed with the fundamental objective to strengthen the soundness and stability of the international banking system and to maintain sufficient consistency that capital adequacy regulation would not be a significant source of competitive inequality among internationally active banks (BCBS 2006:2). Basel II consists of 3 mutually reinforcing pillars: Pillar 1 – minimum regulatory capital for credit, market and operational risks, Pillar 2 – a supervisory review process and Pillar 3 – Market discipline. Pillar 1 presents the methodologies for calculating the minimum capital requirements for credit, market and operational risk. The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets and establishes the minimum level for internationally active banks. The total capital ratio must be no lower than 8%. Pillar 2 provides the key principles of supervisory review, risk management guidance and supervisory transparency and accountability with respect to banking risks (BCBS, 2006:204). It provides for supervisory authorities to require banks to hold capital levels above the minimum level. The purpose of Pillar 3 is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) by encouraging market discipline through the development of a set of disclosure requirements which will allow market participants to assess key information on the capital adequacy of banks. It is aimed at providing a consistent and understandable disclosure framework that enhances comparability (BCBS 2006:226).

Basel II is an exemplary case of international ‘soft law’ where domestic regulations are generated from a legally non-binding international process. The Basel Committee itself does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have any *legal* force. Rather, it formulates supervisory standards and guidelines and recommends statements of best practice in the expectation that individual national authorities will take steps to implement them through detailed arrangements, statutory or otherwise, which are best suited to their own national systems.

Section 2: Why are there large implementation gaps despite numerous compelling reasons to implement Basel II?

Despite the voluntary nature of Basel II and despite that Basel II was not written with developing countries as the primary target, it has been proclaimed as *the* international standard for capital adequacy regulations, with 101 countries indicating that they would adopt Basel II within only months of its finalization (FSI 2004:3). As of 2008, 105 countries have implemented or are currently planning to implement Basel II. 31 jurisdictions had implemented

Basel II by the end of 2007 and by the end of 2008, 57 jurisdictions were on track for implementation (FSI 2008:3).

There are a number of compelling reasons why emerging countries may be (overly) eager to adopt and implement Basel II quickly. The implementation of Basel II is expected to provide the following set of potential benefits to all its users (the first 2 benefits are derived directly from attaining the official stated objectives of Basel II). First, shared capital rules are expected to enhance the stability and soundness of internationally active banks by providing mutual reassurance of reduced counterparty risk or risk of triggering an international financial crisis. Second, capital harmonization may make conditions of competition among banks from different countries more equal. Third, harmonized capital standards and supervisory procedures may facilitate the consistency and effectiveness of supervisory treatment for multinational banks. It may also lead to enhanced international supervisory cooperation derived from a “common language” for communicating bank risk positions. Moreover, a common language developed for supervisory purposes may facilitate trading of credit risk and scrutiny of banks by investors, which may further reduce the cost and enhance the quality of information. Finally, harmonization may yield direct benefits for non-governmental actors by reducing regulatory burdens for multinational banks that adopt a single capital adequacy framework across its international network and are subject to supervision in multiple jurisdictions. (Tarullo 2008:196)

In addition to these generic benefits, emerging economies may have further incentives to adopt and implement Basel II (perhaps prematurely). This impulse arises in part from an aim shared with the Basel Committee regulators, that is, expectations that Basel II will drive advances in bank risk management (and bank profitability) and political pressure to give banks in their own countries the same advantages of reduced capital requirements² that are expected in Basel Committee countries (see Hohl, McGuire, Remolona, 2006 for the case of Asia). Furthermore, emerging countries may be eager to adopt international standards to demonstrate to markets, foreign counterparties, and foreign supervisors that their banks are subject to the same stringent capital requirements as G-10 country banks. This may enhance the reputation of the domestic banking sector and reduce external borrowing costs. In other cases, international standards may be used as a way to catch up with the best practices and supervisory expertise of the leading international financial centers in hope to upgrade domestic practices and create a competitive domestic banking system as part of a highly politicized economic growth strategy.

However, although there are compelling reasons for emerging economies to follow the “best practices” of rich-country supervisors and adopt the most sophisticated banking and regulatory practices, what works well for some countries may not work for others. This may be

² The Basel Committee’s official objectives regarding the overall level of minimum capital requirements are to broadly maintain the aggregate level of such requirements, while also providing incentives, by reduction in the capital requirement, to adopt the more advanced risk-sensitive approaches of the revised capital adequacy framework. (BCBS, 2006:4)

due to capacity limitations, industry structure or fundamental differences in domestic political economic factors such as the configuration of political preferences. Previous experience with international financial standards suggest that although they have been successful for identifying vulnerabilities and establishing priorities for strengthening domestic banking institutions in line with international best practice, implementation and compliance failures in the form of mock compliance, regulatory forbearance and selective/partial implementation have often undermined efforts of reform (Walter, 2003, 2008; IMF 2005; Chey 2006). Furthermore in some cases, the misguided application of international standards has created perverse outcomes such as creating a false sense of comfort. Nonetheless, virtually all governments publicly assert that they are or will be following Basel standards, though the differences in actual implementation and compliance are significant across implementing countries. This paper looks to explain this implementation gap between Basel II and its actual implementation and assess the divergent implementation outcomes amongst a medium-n size sample of emerging countries. It looks at how the objectives and principles of Basel II may directly conflict with that of national supervisors in their pursuit of domestic political objectives, and the extent to which this leads to implementation gaps between Basel II and its actual implementation.

Section 3: Research Questions, Objectives and Hypotheses

This research sub-topic looks at the domestic implementation of Basel II in emerging countries. It consists of 3 research questions. The first research question looks at how conflicts between,

- (a) the stated objectives of Basel II to promote competitive equality (with respect to capital adequacy standards) and strengthen the soundness and stability of the international banking systems, and
- (b) the domestic pursuit of national competitiveness and choice of the level of banking system stability,

produce conflicts of interests amongst domestic actors, and the extent to which this shapes the way in which international standards are implemented domestically. The second research question looks at what the extent of convergence to international standards is (i.e. measuring the implementation gap). The third research question asks whether there are any systematic differences or similarities in the conflicts of interests, implementation strategies and implementation outcomes among a medium-n sample of emerging countries. In short, the research questions are constructed to achieve the following objectives:

- (1) Evaluate the conflicts of interest that shape the way in which international standards are implemented in emerging countries, then;
- (2) Measure and evaluate the extent of convergence (divergence or “quasi-convergence”) to international standards, and;
- (3) Draw causal inferences to explain variations in implementation strategies (comprehensive adoption, mock compliance, localization etc) and outcomes across emerging economies.

The following hypotheses that relate competitiveness and stability to implementation outcomes are derived in “Section 4.4 Defining conflicting objectives of Basel II and domestic political preferences” below.

Hypothesis 1: The strategic pursuit of enhancing national competitive advantages by creating higher regulatory requirements (at the expense of competitive equality) leads to the implementation of a capital adequacy framework that goes beyond Basel II (hence Basel II is not binding).

Hypothesis 2: The pursuit of national competitive advantage by creating lower regulatory requirements (at the expense of competitive equality and/or stability) leads to implementation that falls short of Basel II standards (hence there are large implementation gaps).

Hypothesis 3 is a blend of hypothesis 1 and 2 in that it looks at the case where domestic actors have incentives to visibly signal compliance when in fact their underlying behavior is inconsistent with Basel II.

Hypothesis 3: The shift in the regulatory approach towards emphasis on internal practices and processes increases the scope for opportunistic behavior that creates competitive advantages to national banks (at the expense of competitive equality and stability) and leads to the mock implementation of Basel II.

Section 4: The Analytical Framework: Tradeoffs between Competitiveness and Stability and Conflicts of interests

4.1 The independent variable

The independent variable measures the degree to which the objectives and principles of Basel II may directly conflict with that of national supervisors in their strategic pursuit of domestic political objectives. Expected conflicts of interests due to the tradeoffs between stability and competitiveness are conceptually characterized in the table below. For example, national supervisors may be politically pressured to provide a competitive advantage at the expense of maintaining international stability (“Conflict Type B”).

		Objectives of international standards	
		Competitive equality	International stability
Domestic preferences	Competitive advantage	Conflict Type A	Conflict Type B
	Domestic stability	Conflict Type C	Conflict Type D

The possibilities of conflicts in interests due to conflicting objectives within domestic preferences (between competitive advantage and domestic stability) and within international standards (between competitive equality and stability) are not ruled out. For example, there is some basis for believing that the safety and soundness motivation was eclipsed by the competitive equality motivation during the Basel II negotiation process (Tarullo 2008:200).

Furthermore, competitiveness and stability may not necessarily be conflicting objectives, especially in the long run or in the case of adopting state-of-the art risk management techniques that enhances both the banks competitiveness (through lower capital requirements under Basel II) whilst contributing to the stability of the national and international banking system.

4.2 The Dependent Variable

The dependent variable measures the implementation gap, which is defined as the degree of divergence between Basel II principles and objectives (international standards) and actual implementation in emerging countries. Variations in the dependent variable are conceptually categorized in the table below according to 3 basic outcomes: convergence, adaptation/modification and divergence.

	Substantive Compliance	Mock Compliance
Convergence	Implementation Outcome 1	Implementation Outcome 2
Adaptation/Modification	Implementation Outcome 3	Implementation Outcome 4
Divergence	Implementation Outcome 5	Implementation Outcome 6

Concepts in compliance theory are central to my overall research project for measuring domestic implementation and evaluating convergence to international standards, and hence I have included a column for “mock compliance.” In contrast to formal or superficial compliance to international standards, “substantive compliance” occurs when the underlying actor behavior is consistent with adopted standards. On the other hand, “Mock compliance” occurs when government, bureaucratic and private sector actors may all have incentives to visibly signal compliance when in fact their underlying behavior is inconsistent with adopted standards. The “real compliance gap” refers to the divergence in behavior consistent with substantive and actual compliance, hence, measuring the extent of mock compliance and reflecting an undisclosed policy choice by government (Walter, 2008).

4.3 Plausibility of linking the dependent and independent variable

Despite the technical and seemingly apolitical nature of Basel II, there are a number of reasons to expect variations in the independent variable (political tradeoffs that produce conflicts of interests) to be channeled directly to variations in the dependent variable (implementation outcomes of Basel II). This is likely to be more so the case for emerging countries, who effectively, as consumers of international standards, have to take Basel II as given (in contrast to the producers of Basel II). Firstly, the Basel II framework contains more than 60 areas in which national supervisory discretion may be exercised (BCBS 2004:28-36). Consequently, there is lots of room for opportunistic interests to dictate the exercise of supervisory discretion that may lead to variances in the dependent variable. Supervisors may be subject to both internal and external pressure to relax regulation for the competitive advantage of a country’s

banks at the expense of risking stability in the banking system. As a result, even in formal terms, there are likely to be significant variations in the applicable capital rules across emerging countries. Secondly, although not formally classified as provisions that require national discretion to be exercised, ambiguous or incomplete provisions may require guidance from national supervisors to banks, creating another source of manipulation and differences in the rules. Jackson (2006) notes that banks only have a few years of data for many of the models they will be using to calculate internal ratings. Statistical inferences to be drawn from limited data will be of limited reliability. This increases the need for the exercise of judgments by both banks and supervisors as to whether outputs generated by the models constructed with limited data are actually plausible. Areas where judgments are exercised may expose banks and supervisors to opportunistic pressures. Thirdly, Pillar 2 establishes principles that supervisors should expect banks to operate above the minimum capital level and should have ability to require banks to hold capital in excess of this minimum to account for uncertainties or risks not addressed by Pillar 1. Supervisors are free to put in place supplementary measures of capital adequacy that are more binding than the Basel minimum. This highlights the necessity for national supervisors not simply to import the Basel Committee guidelines wholesale, but to adapt them to local realities (Fitch Ratings 2005). However, strengthening supervisory powers may also strengthen the political clout of supervisors in their pursuit of private interests as opposed to public interest or compliance to international standards. In fact, Barth et al (2006:311) goes further to show that in the absence of political systems of checks and balances, increases in supervisory powers will tend to impede the flow of funds to creditworthy firms and lead to greater corruption in bank lending. Hence, greater supervisory powers may be translated into greater deviations in the implementation of international standards. Finally, the complexity and opaqueness of the IRB approaches are expected to make opportunistic forbearance or manipulation harder to detect (particularly in non-crisis situations). This results in severe monitoring difficulties which may undermine the promotion of competitive equality. Moreover, the soft law nature of Basel II doesn't help either in ensuring compliance (or compliance to an acceptable level). In short, the above analysis highlights the importance of domestic political factors, in particular, the domestic supervisory culture or tradition, in driving implementation outcomes.

4.4 Defining the conflicting objectives of Basel II and domestic political preferences

Given the potential benefits and eagerness of emerging countries to implement Basel II, the following section looks at areas of conflict of interest created by conflicts between the objectives and principles of Basel II and that of national authorities in their strategic pursuit of domestic political objectives. The scope of my analysis is restricted to the official fundamental objectives of Basel II: promoting competitive equality with respect to capital regulation and strengthening the soundness and stability of the international banking system. This, combined with the corresponding domestic political objectives with respect to promoting national

competitiveness and stability, constitute my independent variables, which are hypothesized to lead to divergent Basel II implementation outcomes. This argument is based on the premises that whilst some domestic actors may seek to maximize the soundness and stability of the banking sector and create a level playing field vis-à-vis other internationally active banks, at times the strategic element may work against these forces. Emerging countries may implement international standards strategically to provide a competitive advantage to their domestic banks at the expense of maintaining the integrity of the principles and objectives embodied in Basel II. The tradeoffs inherent in the pursuit of international competitive equality versus national competitiveness and the level of international versus national banking system stability are assumed to create fundamental conflicts of interests for supervisory authorities, politicians, banks and the market. The remainder of this section looks at these tradeoffs.

Capital requirements and stability

From the perspective of national authorities, the level of stability of the national banking system is partially a choice that affects the tradeoff with respect to the cost of capital. Stringent capital regulation may be adopted and strictly enforced if the soundness and stability of the banking system was the primary (and sole) concern of national authorities. However, setting bank capital requirements involves a tradeoff between financial soundness and stability and moving capital to productive uses throughout the economy (which in turn is likely to affect economic growth). Accordingly, capital regulation cannot be a purely mechanical task but necessarily requires the exercise of policy discretion. As with soundness and safety regulations more generally, a government's decision on required capital levels necessarily involves a tradeoff between the cost of capital to firms and individuals (which affects the level of financial intermediation and economic activity) and the possibility of bank failures. Regulation should be justified on the grounds of the optimal social tradeoff between the social cost of capital and the risks of bank failure. Theoretically speaking, Santomero and Watson (1977) suggests that the government should establish minimum capital requirements that equalize the marginal returns from bank capital requirements (social benefits of reduced risk of costly bank failures) and the marginal cost of capitalization (social cost of reduced financial intermediation from higher capital requirements). The social net benefit calculations may lead to a capital level that may or may not promote the integrity of Basel II.

Moreover, this calculation may further conflict with the optimal capital level calculations of banks, which may only take into account the private costs and benefits of capital. From the perspective of banks, higher capital holding restrict the bank's revenue generating activities and impacts their competitiveness and profitability. Again, national authorities may be stuck between the demands of satisfying national banking sector/public interests or the demands of satisfying Basel II objectives (of the wider international banking system) in deciding how it should implement Basel II.

Capital Requirements and Competitive Equality vs. National Competitive Advantage

Similarly, the extent of pursuing competitiveness-driven strategies that discriminate between players in the international banking system is also a choice. Emerging countries may implement international standards strategically in order to promote their own banking sector as the new engine for economic growth and position their economies in the global stage at the expense of maintaining the integrity of the principles and objectives of Basel II (i.e. level playing field and minimum level of bank soundness). However, strategies that promote national competitive advantages do not necessarily imply undercutting national prudential standards and leading an international regulatory race to the bottom. In fact, the relationship between capital requirements and the associated competitive advantages it brings is not well understood. Understanding how supervisory authorities and policy makers understand this relationship and its strategic policy application is a key question that is investigated in my research. The effect of higher or lower capital requirements on bank competitiveness and stability is likely to depend on a number of circumstance-specific factors which lead to the development of the following 3 hypothesis.

First, US banks were among the highly capitalized and most profitable banks globally in the run up to Basel II. One reason may be that higher capital levels signal strength to counterparties, who consequently may be willing to extend funds to the bank at a lower risk premium. Higher regulatory capital requirements may similarly signal to counterparties that a bank's supervisors are more likely to prevent the bank from encountering liquidity or insolvency problems (Tarullo 2008:209-210). This observation leads to Hypothesis 1: The strategic pursuit of enhancing national competitive advantages by creating higher regulatory requirements (at the expense of competitive equality) leads to the implementation of a capital adequacy framework that goes beyond Basel II (hence Basel II is not binding and there are large negative implementation gaps).

Second, it is axiomatic that higher capital holdings restrict the bank's revenue generating activities³. Lower capital requirements in one country may allow internationally active banks in that country to earn supra-competitive returns relative to banks subject to more stringent capital requirements. If one country significantly reduces its capital requirements while holding constant all other relevant factors (including the safety net that bank counterparties and investors believe the government maintains), then that country's banks will gain a competitive advantage relative to the rest. This is one reason why the prospect that the Internal Rating-Based (IRB) approaches⁴ may significantly lower capital requirements has prompted non-BC countries to adopt Basel II quickly and why large US banks were concerned when the implementation process in the US fell behind that in the EU (Tarullo 2008:210).

³ Every additional dollar added to a capital buffer entails a foregone opportunity to lend that dollar and earn interest on it.

⁴ Internal ratings-based (IRB) approaches uses the internal credit models of individual banks to produce risk inputs for calculating regulatory capital in attempt to achieve greater risk sensitivity between regulatory capital and the actual risk faced by banks.

More generally, there may be pressure on national supervisors to relax prudential regulation so as to provide a competitive advantage (on a temporal or permanent basis) to their banks. This observation leads to Hypothesis 2: The pursuit of national competitive advantage by creating lower regulatory requirements (at the expense of competitive equality and/or stability) leads to implementation that falls short of Basel II standards (hence there are large positive implementation gaps).

Third, following the development of the IRB approaches, a key innovation of Basel II, the definition of being a competitive bank is being reshaped. Attention has shifted from focusing solely on the level of the capital buffer towards looking at internal risk management processes. No longer are the competitive banks (and at the same time “well” capitalized, safe and sound banks) those with the highest or lowest capital requirements, but those that adopt A-IRB⁵ approach, which utilizes state-of-art risk management practices. Combined with the negotiating politics of Basel II which reduced the capital requirements for banks that adopted IRB approaches to provide incentives for its adoption, low capital requirements may now become associated with complete banks that are also safe and sound banks. With severe limitations for outsiders to monitor bank’s internal practices, this may be excellent news for emerging countries to pursue mock compliance strategies and achieve the best of both worlds by *appearing* safe due to the superficial adoption of IRB approaches and be competitive due to lower capital levels (at the expense of the soundness and stability of the domestic and international banking system): a quick and cheaper way to look good. With the advent of IRB approaches, or more generally, the shift towards a regulatory approach which puts greater emphasis on risk management practices to assess the soundness of banks and rewarding this through a reduction in capital requirements, opens up incentives for mock compliance/implementation. This observation leads to Hypothesis 3: The shift in the regulatory approach towards emphasis on internal practices and processes increases the scope for opportunistic behavior that creates competitive advantages to national banks (at the expense of competitive equality and stability) and leads to the mock implementation of Basel II.

4.5 Linking conflicts of interests to strategic implementation and then to implementation outcomes

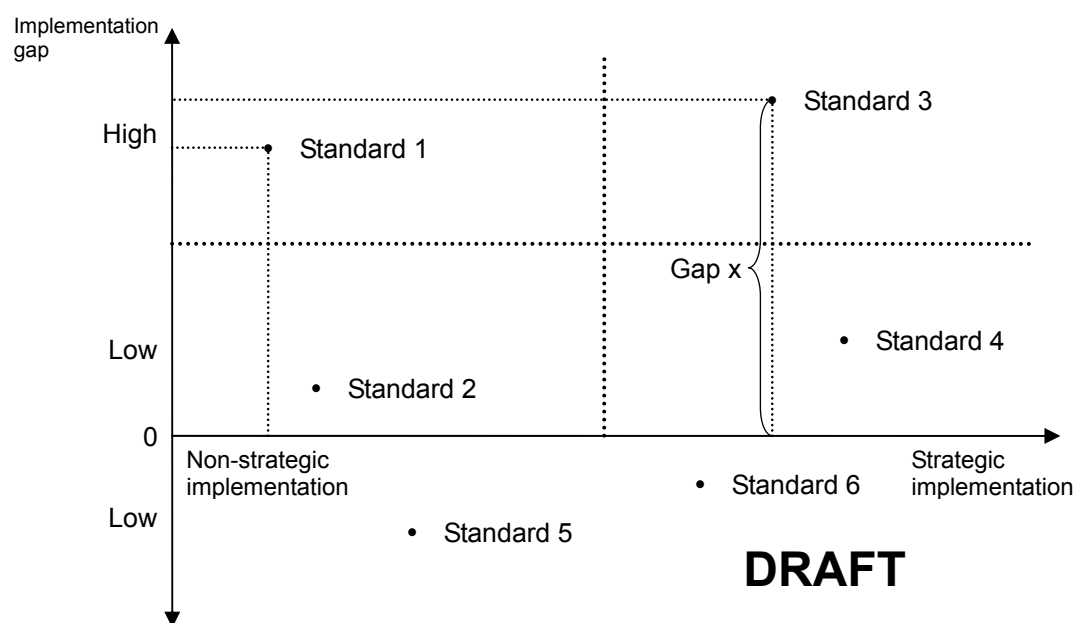
The analytical framework needs to capture the way in which conflict of interests produced by conflicts in (a) the stated objectives of Basel II to promote competitive equality and strengthen the soundness and stability of the international banking systems, and (b) the domestic pursuit of national competitiveness and choice of the level of banking system stability, lead to the strategic domestic implementation of Basel II in emerging countries. Whilst some may seek to maximize the soundness of the banking sector and create a level playing field, at times the strategic element may work against these principles. The next step would be to establish the

⁵ Advanced Internal Rating-Based (A-IRB)

relationship between the extent of strategic implementation to the level of the implementation gap and the overall level of convergence to international standards (i.e. the second research objective).

These points are illustrated in Figure 1 and 2 below. Starting from the assessment of the relationship between the strategic implementation of Basel II and the implementation gap/extent of convergence to international standards in Figure 1, the horizontal axis measures the degree in which standards that were implemented to achieve strategic objectives: from non-strategic motivations of implementation on the left, to strategic implementation on the right. The vertical axis measures the degree of the implementation gap. Four boxes representing different degrees of the implementation gap and strategic intent can be constructed. For example, the top right box represents those international standards that were implemented with a high degree of strategic intent and associated with a significant implementation gap. The objective of this exercise is to find regularities by grouping different provisions of Basel II into these boxes to see whether certain international standards are more prone to strategic implementation and/or significant implementation gaps. For example, the implementation of Standard 3, a hypothetical standard of Basel II (in the red box), indicates implementation driven by strong strategic reasons and a large implementation gap corresponding to “Gap x”. In contrast, Standard 2 in the bottom left green box may highlight the implementation of international standards that may seem to be adopting best practice in a best practice manner (i.e. preserving the integrity of Basel II). The possibility of a negative implementation gap is not ruled out in order to represent cases where implementing countries adopt standards that go beyond Basel II.

Figure 1: Strategic implementation and the implementation gap



Given my overall research question (which this paper partially addresses), the implementation of standards in the bottom left and top left (green and yellow boxes) areas of

the graph are not interesting cases. The analytical focus is put on the top and bottom right boxes, which focus on the strategic implementation of international standards.

Having identified the strategic implementation of international standards, the research question requires establishing the extent to which the strategic implementation was competition-driven or stability-driven. This is illustrated below.

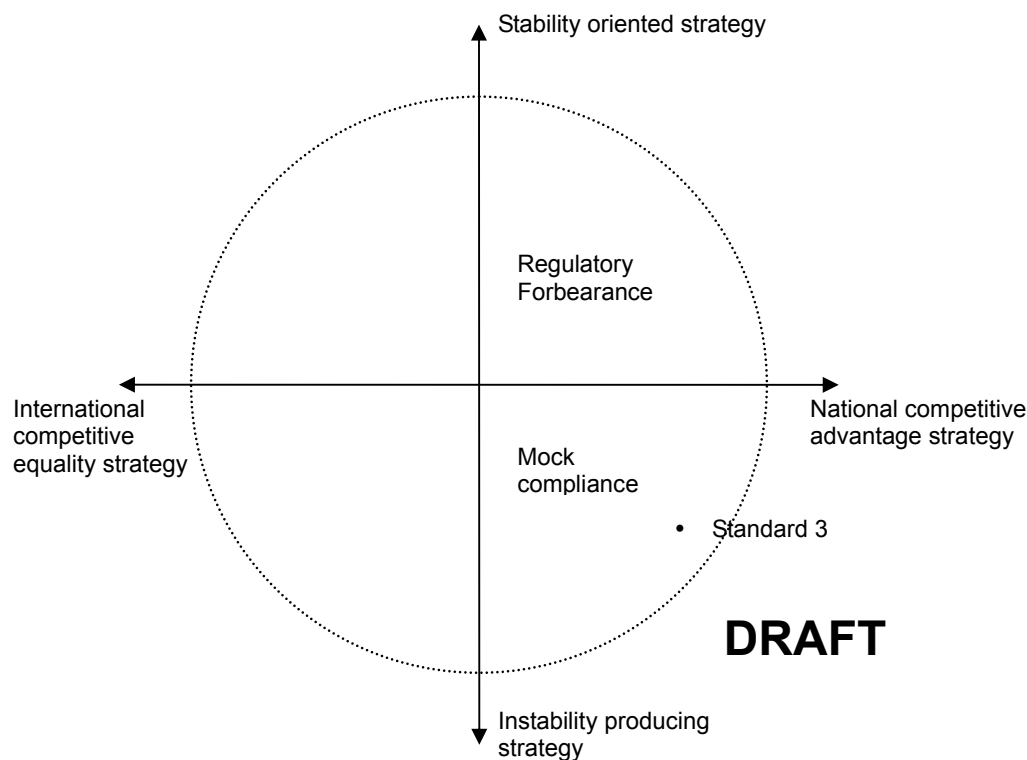


Figure 2: The objectives and drivers of strategic implementation

The objective of this graph is to identify the implementation and compliance strategies (such as regulatory forbearance or mock implementation) for different standards in Basel II depending on the drivers of strategic implementation (which is assumed to result in the implementation gap described above in Figure 1). For example, Standard 3 in Figure 1 that represented implementation for strategic reasons and a large implementation gap (“Gap x”) can also be depicted in Figure 2 whereby the distance between Standard 3 and the origin represents “Gap X” in Figure 1. This would indicate a case where concerns for promoting national competitiveness at the expense of promoting stability in the banking system were the key drivers of the implementation gap that resulted from mock implementation.

Conclusion

This is a concept paper exploring a specific sub-topic of my PhD thesis that looks at the conflict of interests created by the objectives and principles of Basel II and domestic policy preferences. All comments are welcome during and after the conference, especially regarding the conceptual link between the dependent and independent variables.

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