15

Conclusion

Key Findings and Policy Recommendations

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The preceding chapters have provided a wealth of empirical evidence on the political economy dynamics that lead regulators in peripheral developing countries to converge on, and diverge from, international standards. In this chapter we distil key findings, highlight areas for further research, and make a series of policy recommendations, proposing ways to reform international standard-setting processes to better reflect the interests of peripheral developing countries.

Our case studies provide compelling evidence of the powerful reputational, competitive, and functional incentives generated by financial globalization that lead regulators to adopt international standards, even when they are ill suited to their local context. A striking finding from our case studies is that politicians and regulators were the main drivers of convergence. In the countries where implementation was most ambitious, politicians played a vital role, championing the expansion of financial services and integration into global finance as an important component of their country's development strategy. In some cases, regulators advocated convergence on prudential grounds, concerned about the increasing risks posed by internationally active banks. But we also found evidence of strong reputational incentives to implement the latest international standards, which are considered the 'gold standard' in international policy circles.

Where there were pressures to diverge, these usually came from politicians and regulators as well. In several countries, politicians were concerned implementation of international standards would undermine their ability to allocate credit to productive sectors of the economy, as part of a developmental state model, or to channel credit to political allies. In many cases regulators were sceptical about the suitability of international standards for their jurisdiction, particularly the most complex aspects of Basel II and III. Where politicians and regulators faced conflicting preferences, this led to mock compliance. A striking finding is that banks were rarely central players in these dynamics of convergence or divergence.

We explain how our findings speak to wider debates in the literature, including over the agency of actors from peripheral developing countries in the global

Emily Jones, *Conclusion*: *Key Findings and Policy Recommendations* In: The *Political Economy of Bank Regulation in Developing Countries*: *Risk and Reputation*. Edited by: Emily Jones, Oxford University Press (2020).
© Oxford University Press. DOI: 10.1093/oso/9780198841999.003.0015

economy; relationships between firms, politicians, and the state in developing countries; the importance of policy ideas, particularly the role of the financial sector in economic development; and the inner workings of bureaucracies in developing countries. We highlight areas for future research, including fine-grained analysis of political dynamics within government institutions in developing countries, and the trade-offs associated with independent regulatory institutions.

Our final contribution is to set out some detailed policy proposals to reform international banking standards so that they are better aligned with the interests of peripheral developing countries. We highlight the different strategies that regulators can use at the national level to modify international standards at the point of implementation. We also propose ways to improve the voice of governments from peripheral developing countries in international standard-setting processes, by improving their representation, consolidating the evidence base from which regulators can develop alternative policy proposals, and strengthening collaboration among regulators from peripheral developing countries.

Insights from case studies: drivers of convergence and divergence

Our case studies provide compelling evidence that regulators in peripheral developing countries face very strong incentives to converge on international banking standards. Moves to implement international standards reflects some prudential concerns, with regulators seeking to regulate internationally active banks. But the most powerful drivers of convergence are political, emanating from politicians and regulators, rather than banks. We also found evidence of strong incentives to diverge from international standards. Again, politicians and regulators tended to oppose implementation the most, with banks playing a relatively minor role. We provide a summary of how each of our case studies maps onto our analytical framework in Table 15.1, and discuss the most salient features below.

Drivers of convergence

In five of our cases (Pakistan, Rwanda, Ghana, Angola, Vietnam), the main impetus to converge on international standards came from politicians. In Pakistan, Rwanda, and Ghana politicians championed the expansion of financial services and integration into global finance as an important component of their country's development strategy, and perceived implementation of the latest international banking standards as vital for signaling the attractiveness of their financial services sectors to prospective investors. In Vietnam, reformist politicians championed the implementation of international standards as part of a wider strategy to integrate their country into the global economy, rather than to attract investment into the financial services sector per se.

Table 15.1 Drivers of convergence and divergence in our case studies

Country	Drivers of convergence				Drivers of divergence				Pathway	Outcome (number of BII and BIII components implemented)
	Politicians seeking international capital	Regulators engaging with peers	Domestic banks expanding into international markets	Sustained engagement with the World Bank and IMF	Politicians pursuing interventionist financial policies	Politicians and business oligarchs using banks to direct credit to allies	Sceptical regulator	Fragile domestic banks		
Pakistan	✓✳	✓	✓	(✓)	×	×	(✓)	×	Policy-driven convergence	Ambitious implementation (14)
Rwanda	✓✳	×	×	✓	×	×	×	×	Policy-driven convergence	Ambitious implementation (10)
Ghana	✓✳	✓	×	✓	(✓)	(✓)	(✓)	✓	Policy-driven convergence	Ambitious implementation (8)
WAEMU	×	✓✳	×	✓✳	×	×	×	(✓)	IFI-driven convergence	Ambitious implementation (10)

(continued)

Table 15.1 Drivers of convergence and divergence in our case studies (Continued)

Country	Drivers of convergence				Drivers of divergence				Pathway	Outcome (number of BII and BIII components implemented)
	Politicians seeking international capital	Regulators engaging with peers	Domestic banks expanding into international markets	Sustained engagement with the World Bank and IMF	Politicians pursuing interventionist financial policies	Politicians and business oligarchs using banks to direct credit to allies	Sceptical regulator	Fragile domestic banks		
Tanzania	×	✓✳	✓	✓	✓	✓	×	(✓)	Regulator-driven convergence	Selective implementation (8)
Kenya	✓	✓✳	✓	✓	×	×	✓	×	Regulator-driven convergence	Selective implementation (7)
Bolivia	×	✓✳	×	(✓)	✓✳	×	×	×	Regulator-driven convergence	Selective implementation (5)
Nigeria	(✓)	✓✳	✓	×	×	×	✓✳	✓	Regulator-driven mock compliance	Mock compliance (6)

Angola	✓✳	×	✓✳	×	×	✓✳	×	×	Politically driven mock compliance	Mock compliance (5)
Vietnam	✓✳	✓	✓	×	✓	×	✓ ✳	✓	Politically driven mock compliance	Mock compliance (3)
Ethiopia	×	×	×	×	✓✳	×	✓	×	Policy-driven divergence	No implementation (0)

Notes: ✓✶ denotes factor that was strongest influence in driving convergence or divergence; ✓ denotes influential factor; (✓) denotes factor that was present but weak (e.g. there are domestically oriented banks in all case study countries, but they did not always mobilize to shape regulatory decisions); × denotes factor was not present in a meaningful way. With regards to outcomes: Ambitious implementation = includes at least one of the more complex components (internal models under Basel II and/or liquidity or macroprudential/liquidity standards under Basel III); Selective implementation = standardized approaches under Basel II and only microprudential capital requirements under Basel III; Mock compliance = on paper, not enforced.

In contrast to the logic of politicians seeking deeper integration into global finance, in Angola, and to some extent Pakistan, there were pressures to implement international standards to stay connected to global finance. These were particularly strong in the wake of blacklisting by the Financial Action Taskforce. In Angola the implementation of international standards was seen by politicians as an unattractive but necessary condition for maintaining linkages to international banks, a vital mechanism for channelling profits from the oil sector out of the country. Implementation was a defensive move made to restore the country's legitimacy in the eyes of international actors and maintain connections to international finance, rather than an offensive move to expand financial services.

In another five cases (West African Economic and Monetary Union (WAEMU), Tanzania, Kenya, Bolivia, Nigeria) the main impetus to converge on international standards came from regulators, although they tended to be more circumspect than politicians. Regulators were aware of the challenges that international standards pose in nascent financial sectors and in the face of acute resource constraints, and were more likely to push for selective rather than wholesale implementation. In some cases, regulators acted out of prudential concerns. This was most notable in Nigeria where the regulator sought to upgrade regulations and improve supervision in order to manage the risks posed by increasingly complex and internationally active banks. In other cases, regulators advocated implementation to improve home-host supervision and coordinate with other regulatory authorities.

Beyond these more functional drivers, we found evidence that regulators face strong reputational incentives to implement the latest international standards, which are considered the 'gold standard' in the international policy circles in which regulators are engaged. This was particularly striking in Bolivia. In other countries extensive engagement with the IMF, and to a lesser extent the World Bank, generated incentives to converge on international standards. In the West African Economic and Monetary Union (WAEMU), there was direct pressure from the IMF to implement Basel II and III standards.

In most other cases, the IMF and World Bank played an important, but indirect, role. They were a major source of training and technical advice on bank regulation and supervision, and a striking number of central bank governors and senior officials in our case studies had spent portions of their career in international financial institutions. While the advice and training rarely advocated implementation of the full suite of international standards, extensive engagement with international financial institutions helped create a culture of receptivity to international standards and 'best practices' within regulatory authorities. For many senior officials, implementing the latest international standards became a source of professional pride, providing kudos and legitimacy in international policy circles and at home. These dynamics were particularly striking in Kenya, Tanzania, Ghana, and Pakistan.

Surprisingly, banks were not a major driver of regulatory outcomes in any of our countries. In Pakistan the role of banks was most pronounced, but they only emerged as a powerful lobby for convergence once the financial services sector had gained a preeminent position in the economy and domestic banks had reoriented their business models to the international market. Thus it was the changes brought by policy and regulatory decisions that created a powerful vested interest group in favour of convergence, which arguably makes the convergence trajectory hard to reverse.

In Nigeria there was also a critical mass of large internationally active domestic banks, but the drive for convergence came largely from the regulator's concerns about the risks international domestic banks posed, rather than advocacy by the banks themselves. A few domestic banks in Vietnam and Kenya had international operations and while they were generally supportive of convergence, they were not strong advocates. Larger banks in Tanzania expected to derive a competitive advantage vis-à-vis their smaller competitors from the implementation of international standards. They acted collectively through a business association and the creation of institutionalized channels gave them substantial purchase over regulatory decisions accelerating convergence.

The local subsidiaries of internationally active banks were not strong advocates of convergence. In Angola, and to some extent Tanzania, foreign and domestic banks perceived compliance as an unattractive yet important move in the face of rising concerns about compliance with anti-money laundering standards. In other countries, notably Kenya, foreign subsidiaries were a source of technical advice and support to domestic banks and regulators but did not actively call for the implementation of international standards.

The relative absence of banks as the main driver of convergence is surprising, as statistical analysis of Basel implementation in countries outside of the Basel Committee shows that banks with international operations are significant drivers of convergence (Jones and Zeitz, 2019). The discrepancy between the findings of the case studies in this volume and this wider statistical analysis is likely explained by our focus on countries with nascent levels of financial sector development, a stage at which there are few internationally active domestic banks. As the Pakistan case study suggests, it is only when domestic banks have a substantial international presence that they become champions of convergence.

Drivers of divergence

Our research also highlights powerful drivers of divergence from international standards. These were most pronounced in Ethiopia, where regulators have opted not to implement any elements of Basel II or III. However, there were strong incentives to diverge from international standards in eight other countries too, with Pakistan and Rwanda as the only exceptions.

In five countries (Ethiopia, Bolivia, Tanzania, Vietnam, Angola), politicians were wary of implementing international standards. In Ethiopia and Bolivia, and to a lesser extent Tanzania and Vietnam, governments are pursuing a developmental state approach and using a variety of policy instruments to direct credit, which sits uneasily with the market-based approach to credit allocation assumed in the Basel framework. In Vietnam, which is transitioning from a socialist economy to a market economy, conservative factions of the political elite were opposed to the implementation of international standards lest this speed up the marketization of the financial sector and wider economy. Political considerations loomed large for politicians in Angola where politicians were concerned that implementing international standards would undermine their extensive control over domestic banks and allocation of credit to political allies.

Regulators in most of our case studies were sceptical about the suitability of some aspects of international standards for their local contexts. While many faced strong reputational incentives to implement international standards, and pressure from politicians, many officials we interviewed questioned the applicability of more complex aspects of Basel II and III for regulating banks in their jurisdiction. While some regulators were able to reconcile these tensions through selective adoption and modifying standards to fit the local context, regulators did not always have the support from governors and politicians to deviate from what is perceived to be international 'best practice' and design more suitable alternatives.

Regulators also opposed implementation where they thought that it would publicly expose the fragility of some banks and, in the worst case, precipitate a financial crisis. These concerns were particularly pronounced in Vietnam and Nigeria.

Pathways to convergence, divergence, and mock compliance

Overall, the balance of incentives and political economy dynamics between politicians and regulators tipped countries towards convergence, with seven of our eleven cases converging on international standards, albeit to varying extents (Pakistan, Rwanda, Ghana, WAEMU, Tanzania, Kenya, Bolivia). As we might expect, convergence was most extensive when politicians, regulators, and banks supported implementation, as the case of Pakistan illustrates. Convergence also tended to be higher when politicians were the main drivers of convergence than when the impetus came from regulators. Where politicians dominated the dynamics of regulatory convergence, the regulator tended to have less autonomy and fewer resources, and was less likely to be a source of sceptical push-back. This led to more ambitious levels of implementation.

Conversely, where regulators drove the convergence process, usually in cases where they had a relatively high level of autonomy from politicians and substantial

institutional strength, they tended to be more aware of the challenges and while they drove convergence, they took a more selective approach to implementation. This was the case in Kenya and Tanzania. In Bolivia, there was a high level of contestation between regulators who sought very ambitious levels of implementation, and politicians pursuing interventionist financial policies who opposed implementation. This led to a far lower level of implementation than the regulatory authorities had hoped for.

In three cases (Nigeria, Angola, and Vietnam), conflicting incentives on the part of regulators and politicians led to mock compliance. In Nigeria, the regulator was both eager to implement international standards to better supervise large international banks, and worried that implementation would be detrimental to smaller banks. The result was regulatory forbearance towards the smaller banks. In Angola, politicians were conflicted, feeling under pressure to implement international standards in order to persevere correspondent banking links, and worried that implementation would undercut their ability to distribute credit to their allies. In Vietnam, there was contestation among reformist politicians who sought to implement international standards as part of wider efforts to open the economy, and conservative politicians who opposed further marketization. Meanwhile, regulators were attracted to international standards as a means of communicating with bank supervisors in other countries, yet worried that implementation would cause the collapse of weak banks.

Ethiopia is our one case of divergence. Its regulators have remained with Basel I standards and opted out of Basel II and III. Ethiopia is striking as it is the one country where no actor championed implementation. While it is tempting to attribute this to the fact that there are no foreign banks in Ethiopia, and domestic banks are prohibited from operating internationally, we have seen from our other case studies that the interests of banks have not been a decisive factor in explaining convergence. Instead, Ethiopia's decision to diverge is the result of politicians pursuing a state-led development strategy in which the government retains a high level of discretionary control over the allocation of credit. The regulatory authority is fully aligned with this policy. It is striking that Ethiopia and Rwanda, which are often cited as examples of developmental states in Africa (e.g. Clapham, 2018; Goodfellow, 2017; Mann and Berry, 2016), have responded in such different ways to international banking standards. We reflect on this more below.

Insights for scholarship and areas for further research

Several aspects of our research stand out when we situate our findings in the wider literature on developing countries in the global economy, and on the politics of economic reform within developing countries.

Constrained agency in the global economy

It is striking that our cases defy the stereotype of peripheral countries being pressured by international actors to converge on international standards. Such pressures undoubtedly exist in many areas, including other aspects of international finance (Chwieroth, 2010; Drezner, 2007; Gallagher, 2015; Jawara and Kwa, 2003; Phillips, 2017; Sharman, 2008; Simmons, 2001). Yet coercive pressure played a minor role in our case studies. Only in WAEMU, where the IMF championed implementation, and Angola, where the threat of correspondent banks withdrawing their services catalysed action, were external pressures significant drivers of convergence.

Instead convergence was driven primarily by politicians and regulators, and to a lesser extent internationally oriented domestic banks, actively seeking greater levels of integration in the global economy and international policy circles. It was this dynamic of actively seeking insertion into international processes that led to convergence. This does not mean politicians and regulators in our case study countries did not face external constraints; their policy options and regulatory choices were heavily circumscribed by the international context in which they operated. Crucially, because politicians and regulators had few alternative mechanisms for signalling to international investors and professional peers, their quest for international capital and international recognition led them to support the implementation of international standards that were cumbersome and ill suited in many ways to their local contexts.

More profoundly, the preferences and interests of politicians and regulators have been conditioned by their countries' precarious position in the global economy. Vulnerability led to long-term relationships with the IMF and World Bank which, as we have shown, decisively shaped the types of regulatory institutions that exist in our case study countries, and close ties to these institutions continued to mould the underlying preferences of regulatory authorities. Similarly, profound levels of underdevelopment and a shortage of capital led many politicians to make attracting international investment a policy priority. We have shown how the actions of politicians, regulators and banks, are shaped by their connections to international finance as well as domestic factors, and how they manoeuvre within external and domestic constraints. In doing so we contribute to a growing body of literature that draws attention to the agency of actors from weak states in the global economy (e.g. Brown, 2013; Cooper et al., 2009; Jones, 2013; Jones et al., 2010; Lee and Smith, 2008; Mohan and Lampert, 2013; Whitfield, 2009).

The weak influence of banks in the politics of regulation

We have been struck by the finding that banks played a relatively minor role in the domestic politics of banking regulation in our case study countries. Banks

rarely exerted a direct influence over regulatory outcomes. In some countries, banks were subordinate to the state, or politicians. In other countries banks had greater autonomy from the state and politicians, yet they rarely mobilized to try and shape regulatory outcomes.

This finding is striking as banks play an out-sized role in shaping regulatory outcomes in more advanced economies and in larger developing countries (e.g. Johnson and Kwak, 2011; Mattli and Woods, 2009; Maxfield, 1991; Pepinsky, 2013; Stigler, 1971). They also shape international standard-setting processes. Private associations of major firms have played a leading role in setting international standards in areas like accounting and, even when they aren't the principal decision-makers, large financial firms have become adept at shaping international standards (Baker, 2010; Goldbach, 2015; Johnson and Kwak, 2011; Pagliari and Young, 2014; Romano, 2014; Tsingou, 2008; Underhill and Zhang, 2008; Young, 2012).

The difference appears to lie in the nascent nature of the financial sector in many low and lower-middle income countries, where banks have yet to develop the economic and political clout to decisively shape regulations. As we have shown, this leads a distinctive set of political economy logics around banking regulation in low and lower-middle income countries, in which the preferences of politicians and regulators are decisive, and the anticipated reactions of international market actors loom large.

Given how important finance is in processes of development, we have been surprised at how thin the literature is on the politics of credit allocation in low and lower-middle income countries. The relationship between banks, businesses, politicians, and regulators in low-income countries deserves greater scrutiny by scholars, as we have seen how influential these relationships have been in other emerging economies on the trajectory of economic development (e.g. Hutchcroft, 1998; Maxfield, 1991; Pepinsky, 2013). There is a literature on the role of business associations in developing countries, including in African countries, which identifies a series of conditions under which business associations facilitate or impede economic growth (e.g. Bräutigam et al., 2002; Doner and Schneider, 2000). So far scant attention has been paid to the role of banks and other financial institutions in economic development trajectories in low- and lower-middle-income countries, particularly in Africa, and this would be a fascinating area for further research.

The role of policy ideas

While the narrow material, party-political, and reputational interests of politicians and regulators played a role in shaping regulatory outcomes, it is hard to overlook the powerful impact of ideas. Ideas about the financial sector's role in the wider economy, and the role banks should play, decisively shaped regulatory

outcomes. This was most striking in Ethiopia where a very strong set of policy ideas focused on state-led industrialization in which the state retains control over credit allocation. These policy ideas help explain Ethiopia's divergence from international standards.

Equally strong yet very different sets of ideas explain why Pakistan, Rwanda, and Ghana were ambitious adopters of international standards. In these cases, and to some extent Kenya, convergence was driven by policy agendas focused on becoming a financial services hub, as politicians looked to emulate countries like Mauritius, Hong Kong, and Singapore. Implementing the very latest international banking standards is seen as imperative for establishing a financial services hub, just as keeping up with these standards is a priority for many existing financial services hubs (Brummer, 2012; Sharman, 2009). A similar vision has propelled other developing countries to look to expand their financial services sectors (Ghosh, 2007; Patnaik, 2007). In India, a commission was appointed to develop Mumbai as a regional financial centre, on the understanding that the financial centre would generate real sector development throughout the country (Reddy, 2010).

These policy agendas are linked to the fast growth of the global financial sector since the 1980s, and the expansion of pan-regional banks in many developing countries in the past decade. As McKinsey notes in a recent report, 'Africa's banking markets are among the most exciting in the world. The continent's overall banking market is the second-fastest-growing and second-most profitable of any global region, and a hotbed of innovation . . . Africa's retail banking markets are ripe with potential and present huge opportunities for innovation and further growth' (Chironga et al., 2018, pp. 3–4).

Among academics there is a growing literature on industrial policy and the insertion of African countries into global value chains (e.g. Oqubay, 2016; UNECA, 2016; Whitfield et al., 2015). Scholars are, so far, paying much less attention to policies focused on the expansion of financial services and the re-orientation of economies to serve regional markets. In today's age of financial globalization, the strategies of governments in peripheral developing countries towards global finance deserve greater scrutiny.

The accountability of independent government institutions

Our research shows the value of opening up the black box of 'the state' in peripheral developing countries, unpacking the rules, the motives and motivations, and the tensions, capacity, and interests inside bureaucratic institutions. All too often the state is treated as a black box, with little attention paid to the politics within and among government institutions. Our work highlights the importance of central banks as economic and political actors and contributes to the literature on the

trade-offs associated with delegating important policies to independent regulatory institutions.

The creation of independent institutions for regulating banks has long been hailed as an important move to insulate policy decisions from predatory inclinations of politicians, particularly in developing countries (Barth et al., 2006). Having an independent central bank can act as an important commitment device for reassuring international and domestic actors of policy continuity (Ghosh, 2007; Gilardi, 2007; Maxfield, 1997).

But the role of independent institutions is also highly political, and has substantial trade-offs. The global financial crisis and its aftermath have stimulated a very live debate about the merits of central bank independence in countries at the core of the global financial system (e.g. Restoy, 2018; Tucker, 2018). Central to this debate is the observation that central banks have become powerful actors, yet operate with very little oversight. This has led to calls for greater transparency in decision-making and structural reforms to improve political accountability (e.g. Balls et al., 2018).

Scholars have asked similar questions about the merits of independent regulatory institutions in developing countries. While praised by some for being islands of efficiency in a sea of unprofessional corrupt states, such institutions have also been criticized for removing policymaking from the democratic arena (Dargent, 2015). Boylan (2001) argues that central bank independence is often used by right-leaning authoritarian governments to tie the hands of unwilling successors during transitions to democracy, to ensure continuity of economic policies that favour powerful business interests. Teodoro and Pitcher (2017) raise important normative questions about the desirability of creating independent regulatory institutions, particularly in fragile democracies. Rather than insulate technocrats from politics, engagement between bureaucrats and interest groups is important for fostering long-term, politically sustainable policies.

Our research contributes to this debate by revealing the ways in which independent regulatory institutions are not only *dis-embedded* from local politics, but are also more likely to be *embedded* in international processes that make them receptive to international policy ideas, pressures, and incentives. Such embeddedness may lead to learning and an improvement of the quality of decision-making. But we have also have shown how it can also lead to the adoption of international standards that fail to reflect local realities, a phenomenon of 'dysfunctional policy transfer' (Sharman, 2010). Scholars have found a similar trend in other areas, including in intellectual property rights (Deere-Birkbeck, 2009). Dysfunctional policy transfer is particularly likely when regulatory institutions have independence but few resources, making them receptive to international policy solutions without the ability to critically appraise and push-back against them. The WAEMU case shows how the

supranational nature of regional institutions renders them particularly vulnerable to detachment from local politics and contexts.

More generally, there is the need for more fine-grained research on the role of bureaucrats and inner workings of government institutions in developing countries. This is particularly true for African countries where the literature on bureaucratic politics is thin and scholars are too quick to dismiss formal bureaucratic institutions as ineffectual (Pitcher and Teodoro, 2018; Teodoro and Pitcher, 2017). Our case studies illustrate the substantial variation in the autonomy and power that regulatory institutions have over banking regulation, and we started to explore some of the reasons for this. Given how important government institutions are and yet how little we really know about their inner workings in African countries, this is an important area for further research. From where do bureaucrats derive power? How insulated are technocrats from political considerations, and with what implications? How can we account for variation in the politics of bureaucracy across institutions within the same government, and across governments?

Policy implications

Our research generates a series of insights for policymakers that contribute to a wider policy discussion on how to reform international banking standards so they better reflect the interests of developing countries.

Given the problems that implementing international standards poses for peripheral developing countries, many experts advocate greater reliance on sui generis national regulations and strengthened roles for host regulators (Eichengreen et al., 2018; Persaud, 2013). For instance, national authorities could insist that foreign banks can only operate as subsidiaries, not branches, in their jurisdictions, thereby enabling peripheral governments to have greater control over their operations (Persaud, 2013; The Warwick Commission, 2009). They could also make greater use of capital controls and macroprudential measures to help temper destabilizing inflows and outflows of capital (Rey, 2015; Gallagher, 2015; Griffith-Jones et al., 2012; Gallagher, 2015; Akyuz, 2010).

Yet we have shown how the uneven distribution of structural power in the global financial system limits the extent to which national authorities in peripheral countries can act unilaterally, as it can be costly to diverge from international standards. Politicians and regulators in small developing countries, particularly those with nascent financial sectors, are often looking to attract international capital, maintain (or attain) investment grade ratings from international ratings agencies, and stay on good terms with international financial institutions like the IMF. Our research highlights the powerful reputational, competitive, and functional incentives generated by financial globalization that

lead regulators to adopt international standards even when they are ill suited to their local context.

Given these strong incentives, regulators can modify international standards to suit their local context, in order harness their reputational benefits while avoiding the costs of an off-the-shelf implementation. But modifying international standards is costly—sifting through the full suite of international standards and adapting them to fit the local context is a painstaking and resource-intensive task. Such an approach also shifts the burden of retrofitting international standards onto the world's most acutely resource-constrained regulators. An alternative option is to redesign international standards so that they can be more readily used in a wider range of contexts, including low- and lower-middle-income countries.

In the wake of the global financial crisis, there were calls for international standards to be simplified and to build proportionality into their design. But little has changed. The Basel Committee set up a Task Force on Simplicity and Comparability in 2012 but the Task Force paid no attention to the implementation challenges faced by developing countries (BCBS, 2013). Despite concerns raised by regulators from developing countries about the complexity of specific elements of Basel III, the Basel Committee has not addressed them (World Bank, 2015; BCBS, 2017).

Redesigning international standards to better reflect the interests of peripheral developing countries requires providing peripheral developing countries with greater influence over decision-making processes. This in turn requires greater representation of peripheral developing countries at the tables where decisions are made, a stronger evidence base from which to make alternative proposals, and greater institutionalized cooperation among peripheral developing countries, so that they can better champion reforms.

Below we discuss the steps that national regulators in peripheral developing countries can take to modify international standards, and then discuss the reforms needed in international standard-setting.

Modifying international standards before implementing them

Regulators in peripheral developing countries have substantial room for manoeuvre when they implement international standards. International standards are soft-law (Brummer, 2012) and countries outside of the Basel Committee are not subject to peer-review assessments. In previous chapters we have highlighted the manifold incentives and pressures that regulators in developing countries face to implement international 'best practice' standards. While this means it is extremely difficult for regulators to develop their own sui generis regulations and abandon international standards altogether, they still have room to substantially modify international standards before implementing them.

A first option, common among the regulators in our case studies, is to implement international standards selectively. As we have seen, Basel II and III are in practice compendia of different standards so regulators can select those components that are most desirable and feasible to implement. In many peripheral countries, regulators are choosing not to adopt the controversial internal model approaches for assessing risk. They are also cautious in implementing the macroprudential components of Basel III, which pose significant technical and data challenges for regulators.

Regulators can also modify the elements of the standards that they opt to implement, rather than copying and pasting form the Basel II and III rulebook. They can use their intimate knowledge of the domestic financial system to write rules that match local circumstances better than the Basel template. In the Philippines, for example, regulators have adjusted the risk weights for small and medium enterprises to reduce the incentive of banks to move away from lending to these firms.[1] In a more dramatic move, regulators can adjust the perimeter of banking regulation, so that regulations that are aligned with international standards only apply to large internationally active banks, and simpler (although not necessarily less stringent) rules apply to small commercial banks. This approach is common in countries belonging to the Basel Committee (Castro Carvalho et al., 2017). Although regulators in our case study countries are making some minor modifications to international standards, our over-riding impression is that they are nowhere near as bold as many Basel member countries in tailoring the standards to suit their local circumstances.

Greater representation of peripheral developing countries in global standards-setting

A more optimal approach would be to modify international standards to better reflect the interests of developing countries. As discussed in Chapter 1, the vast majority of developing countries do not have a seat at the table where international standards are negotiated. The prevailing system imposes a rigid divide between the countries at the core of global financial governance which set the standards, and countries on the periphery, which have no voice in the process.

In the wake of the global financial crisis, the G20 asked standard-setting institutions to assess the implications of international financial standards for developing countries, and to further open up decision-making processes. In response, the Financial Stability Board (FSB) created an internal workstream on the effects of regulatory reform on emerging market and developing economies (FSB et al. 2011). It also established six Regional Consultative Groups where members and non-members exchange views on financial stability issues and the global regulatory

[1] Discussion with regulator, via videoconference, September 2018.

reform agenda. Little is known about the nature of participation and quality of dialogue because public summaries of the meetings carry very little information, but our interviews with regulators suggest that these fora do not provide meaningful input into or influence over the design of international standards. Instead they function as fora for regulators to trouble-shoot implementation.

There have been calls for a more radical overhaul of global financial governance since the global financial crisis, and many proposals would provide peripheral developing countries with greater representation. Proposals include the creation of an entirely new inter-governmental organization featuring wide or even universal membership in a constituency system akin to that of the IMF or the World Bank, where members of the governing board represent several member countries (Claessens, 2008; Eichengreen, 2009; Stiglitz, 2010).

Yet there is little appetite at the level of the FSB for radical reforms. The FSB members considered, and dismissed, the proposal of conversion into a classic inter-governmental organization as undesirable. They also rejected the proposal of adopting a constituency-based membership system because it would be inconsistent with its institutional model (individual financial agencies are members of the FSB, not states) and because it 'would make FSB discussions more rigid' (FSB, 2014, p. 1). In 2014 the FSB rearranged the Plenary to give more seats to officials from emerging market member jurisdictions (FSB, 2014). At the same time, it reduced the seats of international organizations such as the IMF and the World Bank, who could in principle represent developing country voices, but in practice have done so with negligible effectiveness.

While there is little political appetite for a radical overhaul of global financial governance, more moderate reforms could be pursued. The Basel Committee could amend its charter to explicitly recognize the need for differentiated standards and commit to build proportionality into their design, so that Basel standards can be readily adapted for use in a wide range of jurisdictions. It could also broaden its mandate beyond an exclusive focus on financial stability to recognize the importance of other objectives such as financial sector development and financial inclusion. Even bringing these in as secondary considerations would incentivize more careful analysis in international standard-setting. It would also better align the Basel Committee's mandate with the domestic mandates of regulators from most developing countries, and a sizable minority of high-income countries, which include objectives beyond financial stability (Jones and Knaack, 2019). Rather than waiting to see whether standards generate adverse impacts on developing countries, the Basel Committee could undertake ex ante assessments.

An interesting proposal is the creation of a small multilateral organization to audit international standard-setting bodies, akin to auditor-generals in national jurisdictions, or the Independent Evaluation Office of the IMF and Independent Evaluation Group of the World Bank (Helleiner and Porter, 2010). Outside of the Basel Committee, the Basel Consultative Group could review its membership to ensure it is broadly representative, inviting new members from low- and

lower-middle-income countries. The Basel Consultative Group and the Regional Consultative Groups could move away from the current top-down *modus operandi* of focusing on the implementation of global standards towards facilitating bottom-up proposals to influence their design (Jones and Knaack, 2019).

Creating influential clubs of regulators from peripheral developing countries

Strengthening professional networks among regulators from peripheral developing countries could strengthen their voice in international standard-setting. Informal clubs among the regulators from the world's largest financial centres, often including senior executives from the world's largest financial firms, have had an outsized impact on the design of international financial standards. Yet there are few fora in which regulators from peripheral developing countries meet to develop strong ties and alternative policy proposals.

Regulators from advanced countries, and senior officials from the world's largest financial firms, have used informal clubs to shape international financial institutions. The G30 brings together, on an invite-only basis, very senior representatives from the public and private sectors and academia to work on international economic and financial issues, with international banking a core focus area.[2] Such clubs are together by elite peer recognition, common and mutually reinforcing interests, and pursuit of a common goal. There is competition for ideas and influence but discussions are highly protected from outside pressures, and clubs tend to converge around specific sets of policy ideas (Tsingou, 2015). The fostering of close relations between members of elite clubs can have a powerful effect on decision-making in other fora, including standard-setting bodies in international finance, which are often dominated by members of these informal clubs (Baker, 2009).

Regulators from peripheral developing countries are at a disadvantage because they do not have the equivalent clubs in which to meet and forge a strong sense of identify and cohesion. Thus, even when regulators from developing countries gain a seat at the decision-making table, they encounter a level of cohesion among their counterparts from advanced countries which they do not match. Regulators from peripheral developing countries do meet, particularly through regional professional networks, but the level of engagement and cooperation varies from region to region, and there are very few fora for regulators from different regions to meet each other and strategize.[3] Moreover, these networks rarely publish proposals for the reform of international financial standards. Investing in the creation of an informal club to generate a stronger sense of common identity and formulate

[2] http://group30.org.

[3] A notable exception is the Alliance for Financial Inclusion, which brings together regulators from developing countries to promote financial inclusion: https://www.afi-global.org.

alternative policy proposals, is a mechanism through which regulators from peripheral developing countries could strengthen their influence over international financial regulation.

Strengthening the evidence base for regulators in peripheral developing countries

Our research highlights the paucity of information and evidence available for developing country regulators seeking to diverge from international standards, and develop alternative policy proposals.

The Bank for International Settlements is the primary international institution for supporting central banks to ensure monetary and financial stability, and is renowned for its high-quality research. However it focuses almost exclusively on the regulatory priorities of developed countries. The Financial Stability Institute (FSI), which is a small organization housed within the Bank for International Settlements, does conduct research on countries outside of the Basel Committee, but its core mandate is to support worldwide implementation of global standards, rather than shaping their design.[4]

The IMF and World Bank are the other high-profile international organizations with a focus on financial regulation and, as we have shown in this book, they engage extensively with regulators in low- and lower-middle-income countries Yet, so far they have focused on providing technical advice on how to *implement* international standards, rather than supporting developing countries to shape these standards during the design phase. Despite experts closely affiliated with the IMF and World Bank challenging the relevance of Basel standards for peripheral developing countries (e.g. Barth and Caprio, 2018; Demirgüç-Kunt and Detragiache, 2010) and strong connections to standard-setting bodies, the IMF and World Bank have invested little effort in shaping international standards to better reflect the needs of developing countries. In the context of Financial Sector Assessment Programmes, the IMF and World Bank have warned against hasty Basel II or III implementation in some low- and lower-middle-income countries, but to date they have provided little systematic analysis of how regulators can modify international standards to their needs.

The Bank for International Settlements, IMF, and World Bank could invest greater resources in analysing international financial standards from the perspective of regulators from low- and lower-middle-income countries, increasing their dialogue with regulators from these jurisdictions, and making recommendations to the Basel Committee. Rather than focusing on ways to minimize the harm

[4] For details on the Financial Stability Institute, see here: https://www.bis.org/fsi/index.htm?m=1%7C17%7C629.

and challenges that international standards pose for developing countries, this research agenda should start from the question of what regulations are most needed in peripheral developing countries. This will help to address the fact that there are glaring gaps in the current international regulations, including on regulatory measures to mitigate volatility in international capital flows and address commodity price shocks, two of the biggest sources of financial instability in low- and lower-middle-income countries (Gottschalk, 2016, p. 61; Kasekende et al., 2012; Repullo and Saurina, 2011).

Recognizing the inherent conservatism of these institutions, a challenge associated with the continued dominance of advanced economies in their governance structures, it is equally important that resources are channelled to strengthen policy institutions led by experts from low- and lower-middle-income countries. As we have seen from the international trade sphere, international experts from the global South have been instrumental in supporting the governments of developing countries in their efforts to shape international rules (Scott, 2015). Strengthening such research and policy institutions would help to generate the policy alternatives that are badly needed in order to ensure that financial regulations support sustainable development in countries at the periphery of the global economy.

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