What's Your Sign? -- International Norms, Signals, and Compliance

Charles K. Whitehead

Columbia Law School

Follow this and additional works at: http://repository.law.umich.edu/mjil

Part of the Administrative Law Commons, Banking and Finance Law Commons, Comparative and Foreign Law Commons, and the International Law Commons

Recommended Citation


Available at: http://repository.law.umich.edu/mjil/vol27/iss3/2

This Article is brought to you for free and open access by the Journals at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Journal of International Law by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlawrepository@umich.edu.
INTRODUCTION

Much of the legal scholarship on state compliance with international obligations analyzes states as unitary actors, without also considering the impact of behavior at the small group and individual levels. The unitary

1. State “compliance” refers to conformity between state action and a rule or standard. See Kal Raustiala, Compliance & Effectiveness in International Regulatory Cooperation, 32 CASE W. RES. J. INT’L L. 387, 388 (2000). It differs from (but includes) state implementation of norms through domestic legislation or other domestic processes, focusing on whether states in fact adhere to the implementing measures they have instituted. See Dinah Shelton, Introduction: Law, Non-Law and the Problem of “Soft Law,” in COMMITMENT AND COMPLIANCE 1, 5 (2000) [hereinafter COMMITMENT]. State compliance is particularly important in the case of instruments that regulate the behavior of non-state actors. To be effective, a state must implement appropriate legislation and enforce a “full-blown domestic regime” designed to comply with its requirements. See Abram Chayes & Antonia Handler Chayes, On Compliance, 47 INT’L ORG. 175, 193–94 (1993) [hereinafter Chayes & Chayes, On Compliance]. Except

WHAT’S YOUR SIGN?—INTERNATIONAL NORMS, SIGNALS, AND COMPLIANCE†

Charles K. Whitehead*

INTRODUCTION

Much of the legal scholarship on state compliance with international obligations analyzes states as unitary actors, without also considering the impact of behavior at the small group and individual levels." The unitary

1. State “compliance” refers to conformity between state action and a rule or standard. See Kal Raustiala, Compliance & Effectiveness in International Regulatory Cooperation, 32 CASE W. RES. J. INT’L L. 387, 388 (2000). It differs from (but includes) state implementation of norms through domestic legislation or other domestic processes, focusing on whether states in fact adhere to the implementing measures they have instituted. See Dinah Shelton, Introduction: Law, Non-Law and the Problem of “Soft Law,” in COMMITMENT AND COMPLIANCE 1, 5 (2000) [hereinafter COMMITMENT]. State compliance is particularly important in the case of instruments that regulate the behavior of non-state actors. To be effective, a state must implement appropriate legislation and enforce a “full-blown domestic regime” designed to comply with its requirements. See Abram Chayes & Antonia Handler Chayes, On Compliance, 47 INT’L ORG. 175, 193–94 (1993) [hereinafter Chayes & Chayes, On Compliance]. Except

INTERROGATION

I. A NORMS-BASED APPROACH TO STATE COMPLIANCE

A. Regulatory Networks

B. Network Norms

1. The Coerciveness of Social Norms

2. Norms and Signaling

3. Norms and Levels of Compliance

C. Principal Implications

II. THE BASEL ACCORD AND JAPAN’S EXPERIENCE

A. The Basel Committee and the Accord

B. Japan’s Experience

C. Japan’s Experience, Ten Years Later

D. A New Perspective on Japan’s Experience

E. Accord Compliance Generally

CONCLUSION

© 2006 by Charles K. Whitehead. All rights reserved.

* Research Fellow, Transactional Studies Program, Columbia Law School; Associate Professor of Law, Boston University School of Law, beginning September 2006. I appreciate the support and thoughtful insights, comments, and contributions of Jennifer Amyx, Paul Berman, George Bermann, Richard Bilder, Robert Bone, Hyoung-kyu Chey, John Coffee, Victor Goldberg, Benton Gup, Gillian Hadfield, John Haley, Cally Jordan, Hoi Kong, Janet Levit, Patricia McCoy, Curtis Milhaupt, David Moore, Bryce Quillin, Kal Raustiala, Mathias Reimann, James Spindler, Kentaro Tamura, and David Zaring. In addition, I gratefully acknowledge the support and assistance of the Transactional Studies Program, the Center on Corporate Governance, and the Center on Japanese Legal Studies at Columbia Law School. The usual disclaimers apply.

state is a useful construct for descriptive and analytic purposes. Yet it fails to fully describe interactions among states, which often take place within a less well-defined constellation of power structures, elites, bureaucrats, and other actors who influence state action and compliance. The unitary model, consequently, underestimates the impact on compliance of informal pressures at the small group and individual levels, and of potentially competing interests between domestic and international state representatives.

When individuals are taken into account, analyses of state compliance tend to be descriptive. They document the growth of cross-border coordination among regulators, through formal and informal organizations, conferences, agreements, and relationships, and the resulting development of government or regulatory “networks” that assist states to comply with international obligations. Those analyses, however, provide an incomplete explanation of how network members interact, to what extent network structures influence regulatory behavior, and, in turn,

where the context otherwise requires, references to “states” (or to a particular state) include nations as well as government institutions, regulatory bodies, agencies, and officials acting on behalf of those nations. See ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER 12-13 (2004) (explaining how a description of the international legal system premised only on unitary states is incomplete).


3. See infra notes 59-71, 86-95 and accompanying text.

4. See infra notes 73-76, 149-155 and accompanying text.

5. A network is “a pattern of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the ‘domestic’ from the ‘international’ sphere.” SLAUGHTER, supra note 1, at 14. In this Article, references to a “bank regulatory network” (or similar reference) are to: Annual General Meeting participants of the Bank for International Settlements [hereinafter BIS], see BIS, The BIS in Profile (2006), http://www.bis.org/about/profile.pdf (listing member states); members of the Basel Committee on Banking Supervision [hereinafter Basel Comm. or Committee], see BIS, Fact Sheet—Basel Committee on Banking Supervision, http://www.bis.org/about/factbcbs.htm (last visited Mar. 19, 2006) (listing member organizations); and their staffs, see infra notes 43-45 and accompanying text, comprised of key international bank regulators and supervisors, many of whom hold express, delegated, or other discretionary authority to give effect to international banking standards, see JOSEPH JUDE NORTON, DEVISING INTERNATIONAL BANK SUPERVISORY STANDARDS 257 (1995). In certain cases, the network may extend to senior regulators who participate in regional supervisory groupings. See Peter C. Hayward, Prospects for International Cooperation by Bank Supervisors, 24 INT’L L. 787, 792-93 (1990); Sol Picciotto, Networks in International Economic Integration: Fragmented States and the Dilemmas of Neo-Liberalism, 17 NW. J. INT’L L. & BUS. 1014, 1041 (1997). In the case of Japan, bank regulatory network members typically have included officials from the International Finance and Banking Bureaus of the Ministry of Finance, which was principally responsible for supervising Japan’s financial services industry (succeeded by the Financial Services Agency), and the Bank of Japan.
how those factors influence state action. The result is a recognition of the role of small groups and individuals in state-to-state coordination without the benefit of a framework to fully describe how state compliance is affected by the network (and other) forces that influence senior regulators.

Norms-based analyses of state compliance, as well, have tended to consider the broad international norms within which states and state relationships exist without fully analyzing the relationships between norms and networks at the individual or small group levels. Some scholars contend that a normative presumption of compliance, in the absence of strong countervailing circumstances, guides state action. Others analyze the process by which states create and internalize international norms. Still others accept the constructivist role of norms in the international decision-making process, partly as a means to explain why certain states value compliance more than others.

This Article proposes a new approach to understanding state compliance with international obligations, positing that increased interaction among the world’s regulators has reinforced network norms.


7. See Benedict Kingsbury, The Concept of Compliance as a Function of Competing Conceptions of International Law, 19 Mich. J. Int’l L. 345, 368 (1998) (Interactions among regulators and between regulators and others “are not well captured in standard international legal typologies (e.g., the sharp sources-based distinction often drawn between binding and non-binding norms).”); Robert E. Scott & Paul B. Stephan, Self-Enforcing International Agreements and the Limits of Coercion, 2004 Wis. L. Rev. 551, 628 (2004) (“[W]e need a theory that can better explain the relationship between individual preferences and the behavior of states.”).


11. In this Article, “network norms” refers to norms formed among regulatory network members. The term “norms” has been variously defined, but it is understood generally to refer
as evidenced in part by a greater reliance among states on legally nonbinding instruments. This Article also begins to fill a gap in the growing scholarship on state compliance by proposing a better framework for understanding how international norms influence senior regulators and how they affect both state decisions to comply as well as levels of compliance.12

This new approach suggests that, under certain circumstances, network forces affecting state action may permit levels of compliance that differ from those expected by market and other actors outside the network. Market forces, consequently, may impose costs for a failure to comply, even in the absence of network sanction. Network norms may also raise agency questions for regulators who are both national representatives and network members, requiring them to balance their interests in enhancing network status and effectiveness against competing interests at home. Regulation's prospective role in balancing that conflict highlights the importance of emerging scholarship on global administrative law and procedure.

12. See Andrew T. Guzman, A Compliance-Based Theory of International Law, 90 CALIF. L. REV. 1823, 1832 (2002) ("[W]e have no theory of why norms operate as a force for compliance. Without a theoretical framework, the norms argument is not helpful in understanding state behavior."); Janet Koven Levit, A Bottom-Up Approach to International Lawmaking: The Tale of Three Trade Finance Instruments, 30 YALE J. INT'L L. 125, 131 (2005) ("[I]n their wariness of the state, [norms] scholars neglect government technocrats as a source of transnational social norms and likewise fail to explore the relationship between informal norms and formal law.").

For illustration, I rely principally on the Basel Accord of 1988, which set an international standard for minimum risk-weighted bank capital; Japan’s experience in complying with the Accord; and recent studies indicating that state compliance with the Accord may vary significantly from state to state. Any analysis of Accord compliance must include Japan in light of that state’s global prominence in the banking industry.

Before proceeding, I wish to note two caveats. First, I am sensitive to my reliance on Japan’s experience in complying with the Accord to illustrate the influence of network norms on compliance. Cross-border interaction among state representatives is likely to differ from field to field in both frequency and kind and compliance may be impacted by whether or not an instrument, like the Accord, is legally binding. Consequently, while this Article’s approach may extend to networks generally, differences in how members interact and across instruments may affect the influence of network norms on state action. In addition, empirical data on network effectiveness and compliance with international obligations is

13. Basle Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards (July 1988), http://www.bis.org/publ/bcbs04a.pdf [hereinafter Accord or Basel Accord]. Authors refer variously to the “Basle” or “Basel” Accord. This Article uses “Basel,” except in quoting or citing others who have adopted a different spelling. The Basel Committee announced revisions to the Accord in November 2005, following five years of proposals, consultations, and studies, to be implemented in late 2006 and 2007. The revised accord (commonly known as “Basel II”) is principally organized along three pillars: Minimum Capital Requirements; Supervisory Review Process; and Market Discipline. The first pillar establishes capital requirements that are more risk-sensitive than in the original Accord, relying to a much greater degree on each bank’s own risk assessments. The second pillar provides guidelines for supervisory review of bank efforts in assessing capital adequacy. Public disclosures provided under the third pillar are intended to reinforce the first two by providing market actors with sufficient information to gauge a bank’s capital adequacy. Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Nov. 2005), http://www.bis.org/publ/bcbs118.pdf.

14. See infra notes 240–244 and accompanying text. Those variations have competitive implications, potentially providing banks in states with lower capital requirements with pricing and regulatory advantages. See infra notes 168, 204 and accompanying text.


17. Compare Guzman, supra note 12, at 1881 ("Agreements among states lie on a spectrum of commitment. The same reputational issues influence such promises regardless of the form in which they are made, but the magnitude of the reputational effect varies with the level of commitment."), with Scott & Stephan, supra note 7, at 591 (Guzman “collapses the question of the reputational effects and formal international-law doctrine in a way that assumes that international-law experts are the only relevant audience.”).
limited, 18 and so reliance on a particular case study may offer the most useful guidance at this stage. 19 Analyzing the Accord is also relevant, since it is often held out as an example of the effectiveness of nonlegal instruments in global regulation. 20

Second, analyzing the potential effects of network norms on regulators raises some special difficulties. The impact of network norms on a regulator may vary depending on her seniority, and so the level at which one considers those effects may also influence the analysis. National differences in institutional and social structure, as well, influence how norms affect behavior and regulatory action. Consequently, this Article should be considered a first step towards better understanding the relationship between network-based forces and state compliance. A norms analysis provides a useful, but preliminary, framework to consider the effect of those forces on levels of state compliance.

This Article proceeds in three stages. Part I analyzes the potentially coercive effect of network norms on network members. Groups may develop norms with which all members are expected to comply and corresponding sanctions for a failure to do so. Compliance with those norms may be costly, reflecting competing political or other interests at home. Network cooperation, however, is important to financial regulators, who must coordinate with others in order to remain relevant to the institutions they oversee, and so defection may be costlier. Members, therefore, have strong incentives to signal their cooperation, particularly if a failure to do so weakens their standing and influence within an important network.

18. Regarding networks, see Kenneth Anderson, Squaring the Circle? Reconciling Sovereignty and Global Governance through Global Government Networks, 118 Harv. L. Rev. 1255, 1278 (2005) (Network effectiveness "is, as an empirical matter, in many instances probably fiendishly difficult to answer."). Regarding international compliance, see Oona A. Hathaway, Do Human Rights Treaties Make a Difference?, 111 Yale L.J. 1935, 1937 (2002) ("[T]he claim that international law matters was until recently so widely accepted among international lawyers that there have been relatively few efforts to examine its accuracy."); Kingsbury, supra note 7, at 346 ("[I]n many areas we simply do not have systematic studies to show whether or not most states conform to most international law rules most of the time." (citations omitted)).

19. Generalizations based on case studies may also involve pitfalls, see Gregory Mitchell, Case Studies, Counterfactuals, and Causal Explanations, 152 U. Pa. L. Rev. 1517, 1545–61 (2004), and so the framework proposed in this Article is offered as only one explanation of the impact of network norms on regulators and compliance.

20. Network relationships in financial fields outside of banking have characteristics that are similar to those described in this Article. See David Zaring, Informal Procedure, Hard and Soft, in International Law, 5 Chi. J. Int'l L. 547, 569–72 (2005) [hereinafter Zaring, Informal Procedure] (describing similarities in global regulatory relationships in the banking, securities, and insurance industries). Those similarities suggest this Article's analysis may apply, as well, to network forces outside of the banking field, such as in international securities and insurance regulation.
Network norms also help define which state actions constitute signals and the meanings of those signals. A state action that is observable by others (such as implementing the 8% capital minimum in the Basel Accord\textsuperscript{21}) may be considered the concrete expression of an abstract network norm (such as a norm of cooperation).\textsuperscript{22} State representatives who implement the 8% minimum may be seen as signaling their support of the broader norm; those who fail to do so may be understood to have defected from the network.

Actual compliance, however, may be weaker. A state may fail to fully comply with an international standard yet not be considered in defection, perhaps reflecting an understanding among network members that partial compliance is still "close enough." States, therefore, may signal compliance when they implement the relevant standard, even when actual compliance is lower. If this description is accurate, then traditional concepts of "compliance" may not apply internationally; rather, what constitutes compliance may vary among networks and over time, based on differences in network norms.

Part II provides a summary of Japan's experience with the Accord to illustrate the new approach described in this Article. Japan's compliance has been checkered—initially believed by Japan's regulators and banks to be manageable but increasingly difficult as Japan's banking industry weakened. Japan's authorities, nevertheless, have maintained the Accord's 8% minimum, even while amending accounting, tax, and other rules and forbearing from fully enforcing Japan's capital regulations in order to help Japanese banks meet that minimum.

Within the new framework proposed by this Article, implementing the 8% standard was important to Japan, signaling to global regulators Japan's willingness to cooperate, even when actual compliance with the

\textsuperscript{21} The 8% capital minimum is applicable to internationally active banks. For a description of the Accord and the 8% minimum, see infra note 146.

\textsuperscript{22} For an account of the Accord's creation, see ETHAN B. KAPSTEIN, GOVERNING THE GLOBAL ECONOMY 103-28 (1994) [hereinafter KAPSTEIN, GLOBAL ECONOMY]; infra at notes 169-172, 180 and accompanying text. Why 8% (as opposed to another network standard) was adopted is beyond the scope of this Article, although norms scholarship may provide a framework for future research. For example, a group's leaders may be instrumental in developing or changing norms. See, e.g., Lessig, Social Meaning, supra note 11, at 982-86 (Soviet "cultural management"); Cass R. Sunstein, On the Expressive Function of Law, 144 U. PA. L. REV. 2021, 2030-31 (1996) [hereinafter Sunstein, Expressive Function] (norm entrepreneurs). Alternatively, individuals may develop norms that catalyze the formation of groups. See, e.g., McAdams, supra note 11, at 358-61 (consensus about esteem-worthiness of certain behavior may give rise to group norms); Sunstein, Social Norms, supra note 11, at 920 (people dissatisfied with prevailing norms can leave one group for another). Members of existing close-knit groups may also develop norms through informal and repeated interaction. See, e.g., ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 167 (1991) (cattle ranchers); Robert Cooter, Normative Failure Theory of Law, 82 CORNELL L. REV. 947, 950-51 (1997) (examples of small groups that have developed informal rules for cooperation).
Accord was lower. Japan’s implementation and enforcement reflected competing domestic interests, on balance favoring formal implementation of the Accord but forbearance from fully enforcing its terms. Network norms, however, may have modified members’ understanding of what levels of compliance were acceptable, particularly in light of the extraordinary decline in Japan’s economy. Even in the face of weak compliance, Japan may not have been perceived by network members to have defected from the Accord.

A recent International Monetary Fund (IMF) study suggests that Japan’s experience may not be isolated. While over 100 states have implemented the 8% minimum, the IMF study suggests that a significant number of them may forebear from fully enforcing the Accord’s terms.\textsuperscript{23}

The conclusion notes that the practical effect of global standards may vary substantially at the national level so long as administration differs from state to state. Those differences may partly reflect network norms and other forces that permit variations in state compliance.

I. A NORMS-BASED APPROACH TO STATE COMPLIANCE

A number of theories have been advanced to explain levels of state compliance with international obligations.\textsuperscript{24} Much of the international law scholarship considers states as unitary actors without analyzing the relationship between individual behavior and state compliance.\textsuperscript{25} States, of course, continue to be the most important actors in the international system. Nevertheless, individuals, not states, maintain the global relationships from which standards like the Accord emerge.\textsuperscript{26} Consideration

\textsuperscript{23} See infra notes 240–242 and accompanying text.


\textsuperscript{25} See supra notes 1–7 and accompanying text.

\textsuperscript{26} See Enrico Colombatto & Jonathan Macey, A Public Choice Model of International Economic Cooperation and the Decline of the Nation State, 18 CARDOZO L. REV. 925, 931 (1996) ("Institutions in general, and governments in particular, do not have preferences, people do."); Scott & Stephan, supra note 7, at 593 (noting that domestic "[r]egimes comprise individuals").
of those relationships is important to an understanding of the forces that affect state compliance.\(^{27}\)

Norms-based analyses also tend to consider states as unitary actors.\(^{28}\) One notable exception is Harold Koh’s theory of transnational legal process, which posits that state compliance may improve as states internalize international norms,\(^{29}\) over time generating internal, self-reinforcing patterns of compliance and, if effective, obedience through a complex series of social, political, and legal processes.\(^{30}\)

In this Part, I propose a new approach to understanding state compliance based upon an analysis of regulatory networks, norms, and signaling. Consistent with Koh, this approach suggests that increased interaction among global regulators has reinforced international norms, affecting the outlook and actions of senior regulators and, in turn, influencing levels of state compliance with international obligations.\(^{31}\) The implementation of certain network standards may signal a regulator’s support for, and be supported by, abstract network norms of cooperation.

I then consider the potentially coercive effect of norms—their ability to compel “‘public conformity without private acceptance,’” with states formally adopting global standards, even in the face of competing domestic interests, without fully enforcing them.\(^{32}\) Resulting levels of state compliance may reflect a balance between these two forces, with lower levels still sending the “right” signal if a network norm excuses defection. The relational nature of instruments that evidence a norm may permit states to vary levels of compliance yet still be understood among network members to signal support for that norm. I suggest some principal implications of this new approach at the end.

A. Regulatory Networks

The growth of cross-border regulatory networks has helped extend the reach of domestic regulators, permitting bureaucracies to close gaps across

\(^{27}\) See infra notes 59–71, 73–76, 86–95, 149–155 and accompanying text; see also Johnston, supra note 2, at 149 (“[C]ausal processes by which systemic normative structures ... affect behavior [in international relations] are mostly assumed rather than shown.” (footnote omitted)).

\(^{28}\) See supra notes 8–10 and accompanying text.

\(^{29}\) Koh, International Human Rights, supra note 9, at 1400–01.

\(^{30}\) Id. at 1406–14.

\(^{31}\) See id. at 1399, 1409–10.

\(^{32}\) Franklin J. Boster, Commentary on Compliance-Gaining Message Behavior Research, in COMMUNICATION AND SOCIAL INFLUENCE PROCESSES 91, 96 (1995) (citation omitted). Even where states have internalized norms, it is common for there also to be external sanctions for a failure to comply. See Gary Goertz & Paul F. Diehl, Toward a Theory of International Norms, 36 J. CONFLICT RESOL. 634, 638 (1992).
jurisdictions and facilitating a convergence in standards and regulation. At the same time, network cooperation has become increasingly important to financial regulators as one means of keeping pace with the growing globalization of the financial industry. Cross-border networks, consequently, play an increasingly important role in the daily lives of senior regulators.

By facilitating increased levels of interaction, networks assist in forming long-term relationships among like-minded regulators in different states—in some instances, with interests far more in common with their international counterparts than with peers in their home state. Over time, as one observer has noted, networks foster "the creation of common ties, personal relationships, camaraderie, a shared professional and social outlook, and an expectation that what others in the network think of what I do in my home jurisdiction ... genuinely matters." In doing so, network members may become professionally socialized and incorporated into organized patterns of interaction, gradually taking on group-based ways of thinking and acting and giving up the "privilege of dissonance" while they remain a part of the network. Networks, in fact, exhibit many of the same characteristics that norms scholarship predicts among group members—the building of relationships, the exchange of

33. See Raustiala, supra note 6, at 24-25.
34. See infra notes 127-130 and accompanying text. See also Jonathan R. Macey, Regulatory Globalization as a Response to Regulatory Competition, 52 EMORY L.J. 1353, 1354-55, 1357-58 (2003) (proposing that regulatory globalization is a "survival response" by bureaucrats threatened by increased competition and private sector globalization); David Andrew Singer, Capital Rules: The Domestic Politics of International Regulatory Harmonization, 58 INT'L ORG. 531, 543-44 (2004) (noting that international regulatory harmonization is more likely to occur when exogenous shocks affect domestic market confidence or competitiveness).
35. Raustiala, supra note 6, at 4-5. See also Ethan Barnaby Kapstein, Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence, 46 INT'L ORG. 265, 267-68 (1992) (describing common characteristics of central bankers).
36. Macey, supra note 34, at 1372.
37. Anderson, supra note 18, at 1272. Like Anderson, my own experience in international banking is that socialization is a key function of cross-border regulatory networks. See also Raustiala, supra note 6, at 55 n.253 (noting that government interviewees stressed the importance of network socialization to regulatory export).
39. Johnston, supra note 2, at 150. A well-known study of the controlling effects of socialization is set out in NORBERT ELIAS, THE CIVILIZING PROCESS (Edmund Jephcott trans., Blackwell Publishers 1994) (1939). Elias used a number of examples, including the evolution of table manners and polite speech, to illustrate how socialization in medieval societies provided central authorities with a means to control other classes. Id. at 269-72.
40. Anderson, supra note 18, at 1272.
information, the development of network standards, and the professional socialization of members.\textsuperscript{41}

Global networks also function as conduits for information regarding their members—their competence, quality, integrity, and professionalism—and rely on many of the same mechanisms, such as reputation, information, and exclusion, that typically reinforce group cohesion and norms.\textsuperscript{42} Adhering to network-based standards may encourage praise, and deviation may cause embarrassment or shame\textsuperscript{43} that results in a loss of prestige or influence among peer regulators as the violation becomes known to others.\textsuperscript{44}

In the financial world, networks typically are comprised of informal organizations, like the Basel Committee on Banking Supervision, with representatives selected from among top central bankers and regulatory officials.\textsuperscript{45} Around them are senior directors, officials, and other banking figures who typically engage in informal and personalized contacts with global peers through Committee membership and activities in other international organizations.\textsuperscript{46} Interaction among bank regulatory network members may extend beyond the Basel Committee, for example, to G-10 meetings where network membership overlaps, potentially making network standing important to, and influenced by, relationships outside the network.\textsuperscript{47}

\begin{thebibliography}{99}
\bibitem{41} Slaughter, supra note 1, at 3-4. See also Amitai Aviram, Regulation by Networks, 2003 BYU L. Rev. 1179, 1225 (2003) (describing the creation of a "common culture" among network members).
\bibitem{42} Slaughter, supra note 1, at 136-37, 196-200. See also Aviram, supra note 41, at 1205-07 (noting that the use of reputation, information, and exclusion reinforces network norms).
\bibitem{43} See John Braithwaite & Peter Drahos, Global Business Regulation 555 (2000) ("[I]nformal praise and shame were often found to be important" in epistemic communities formed around the globalization of business regulation.); Aviram, supra note 41, at 1225 ("[In networks] a common culture creates a unique good—esteem or social standing in the group—which can be a powerful motivator to follow the norms of the group.").
\bibitem{44} Slaughter, supra note 1, at 54-55.
\bibitem{45} The Committee was formed under the auspices of the BIS in Basel, Switzerland, in 1974. Membership is comprised of representatives from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. See Norton, supra note 5, at 171-244 (providing a detailed description of the Committee and its history). See also David Zaring, International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations, 33 Tex. Int'l L.J. 281, 287-91 (1998) [hereinafter Zaring, Other Means]; Zaring, Informal Procedure, supra note 20, at 555-61.
\bibitem{46} Picciotto, supra note 5, at 1042.
\bibitem{47} BIS and Basel Committee members actively participate in other meetings among global financial leaders and regulators, such as the G-10 summits. See C. Fred Bergsten & C. Randall Henning, Global Economic Leadership and the Group of Seven 13-15 (1996); Peter I. Hajnal, The G7/G8 System: Evolution, Role and Documentation 45-46 (1999); John M. Berry, Banking's Key Players, Wash. Post, June 28, 1998, at H01 (describing overlapping memberships in G-10, BIS, and the Basel Committee and cross-border
Regulators are subject to a spectrum of pressures that affect their actions and influence the exercise of their "considerable discretion" in coordinating with their foreign counterparts. The historical and social context of international negotiations, for example, may influence how regulators interact. As I describe below, network norms may also influence members' actions and, in turn, state compliance with international obligations. I consider three characteristics of network norms in this section.

First, network norms may be coercive. A member may have little control over the creation or enforcement of a norm but may risk incurring network sanction for failing to comply with that norm. A state may, as a result, implement a network norm even in the face of competing domestic interests. Actual compliance, however, may reflect a balance between network benefits/sanctions and those interests.

senior and staff relationships). Like the BIS and Basel Committee, G-10 meetings reinforce social relationships among senior regulators through summits and year-round meetings at the ministerial and subministerial levels. See Hajnal, supra, at 35–44 (describing G-7 meetings). As one observer has commented, those meetings create consensus "through the ... deliberative function of forcing the leaders to get acquainted, listen and learn about one another's national constraints, priorities and goals, exchange confidences directly and privately, and thereby create the trust that leads to effective ongoing relationships, especially at times of shocks or crisis." John Kirton, The Summit as An Effective Global Concert, in The Diplomacy of Concert: Canada, the G7 and the Halifax Summit (1995), http://www.g8.utoronto.ca/scholar/kirton199501/cfp95glo.htm.

Richard B. Bilder, Beyond Compliance: Helping Nations Cooperate, in COMMITMENT, supra note 1, at 68 ("[O]fficials will usually assess how they expect foreign office officials to behave on the basis of all the varied considerations and pressures which they see as acting on those officials, not simply on the basis of alleged 'hard' or 'soft' norms alone.").

49. Singer, supra note 34, at 534–35 (noting, however, that regulatory discretion is constrained by legislative preferences). See also infra note 74 and accompanying text for a discussion of the two-level game metaphor.

Second, network norms help define which state actions constitute signals and the meanings of those signals. Depending on context, implementing a network-based standard may be considered a concrete expression of support for a more abstract norm of cooperation. That signal may be accepted by others, even if actual compliance is weak, due to the associated costs of implementing and committing to that standard.

Third, network norms may modify levels of compliance that are acceptable to network members. States, for example, may fail to fully comply with a global standard yet be understood by network members to be “close enough” when that deviation is excused under a network norm.

1. The Coerciveness of Social Norms

By limiting discretion, social norms may coerce the actions of network members. Typically, no single member controls the creation of a norm or any associated reward or punishment for compliance or defection, although all members may be subject to the constraints on behavior which that norm imposes. The result, as Cass Sunstein has noted, “can be a serious obstacle to freedom in the fact that individual choices are a function of social norms, social meanings, and social roles, which individual agents may deplore, and over which individual agents have little or no control.” Reflecting that tension, international government negotiators are often split when setting global standards between a desire to maintain their own flexibility and an interest in increasing the predictability of their counterparts’ behavior.

Norms regulate behavior by taxing and subsidizing actions associated with defection and compliance. Adherence to a network norm may

---

51. The role of coercive power in interpersonal and group relations has long been recognized. See, e.g., John R.P. French, Jr., A Formal Theory of Social Power, 65 PSYCH. REV. 181, 183-84 (1956) (describing different bases of interpersonal power). “Coercion” refers to an exercise of power by a person (or persons) over another (the “target”) through the threat of sanction if the target fails to act as requested. Michael D. Bayles, A Concept of Coercion, in COERCION, NOMOS xiv 16, 17 (J. Roland Pennock & John W. Chapman eds., 1972). The target may ignore the request, but it will be sanctioned for doing so. Id. at 18. Rewards and punishments are “social” where only those groups valued by the affected actor can provide them.

52. As Lawrence Lessig notes, “Social norms regulate as well. They are a second sort of constraint [after law].” Lawrence Lessig, The New Chicago School, 27 J. LEGAL STUD. 661, 662 (1998). “Norm entrepreneurs,” however, may influence changes in behavior by exploiting private dissatisfaction with existing norms. Sunstein, Social Norms, supra note 11, at 929. Internationally, elites may also affect group norms, acting as “deft puppeteers, capable of pulling strings and moving big players that remain passive until activated by someone who can show them where their interests lie.” BRAITHWAITE & DRAHOS, supra note 43, at 495.

53. Sunstein, Social Norms, supra note 11, at 910.


55. Consequently, a larger group may reinforce members’ incentives to adhere to a norm if the magnitude of influences on individual action—the costs of defection and benefits
enhance a member's status among her network peers. Violation, conversely, may cause network members to apply sanctions, most effectively by dismissing (or threatening to dismiss) the violator from the group. Dismissal, however, is a harsh punishment and rarely used among international regulators. It also presents a classic end-game problem—the dismissed member, feeling she has little to lose by challenging the norm, may behave in a manner that is costly to the remaining members.

Norms scholarship, therefore, posits that norms may evolve through more subtle means of reward and punishment involving group prominence, social approval, shame, and guilt—in other words, group or peer pressure. Thus, the Basel Committee uses peer pressure to enforce consensus when there are different or dissenting views. The resulting of adherence—increases at a rate greater than the increase in related transaction costs. See Johnston, supra note 2, at 187–88 ("From a social influence perspective . . . more may be better."); Barak D. Richman, Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering, 104 COLUM. L. REV. 2328, 2340 n.36 (2004) (observing that reputation mechanisms, including those resting on social norms, can remain effective as community size grows when they spread accurate and necessary information). See also Eisenberg, supra note 11, at 1263–64 (examining the critical mass and tipping effects of norms); Raustiala, supra note 4, at 62–70 (noting the network effects of regulatory convergence through transgovernmental networks).


See also Slaughter, supra note 1, at 200–01 (members are reluctant to censure one another).

See Bernstein, supra note 56, at 129 (suggesting that expelled members may turn to legal remedies in contravention of a norm that directs reliance principally on extralegal measures). See also Slaughter, supra note 1, at 200 (noting that network suspension may be more effective than exclusion).

See, e.g., McAdams, supra note 11, at 355–75 (proposing an esteem-based theory of the creation and maintenance of norms). The relative importance of those pressures in forming norms may vary among states. Sociologists note, for example, the relative pervasiveness of shame in Japanese culture, in contrast to the prominence of guilt in the United States. See, e.g., Millie R. Creighton, Revisiting Shame and Guilt Cultures: A Forty-Year Pilgrimage, 18 ETHOS 279, 301–03 (1988). Some experts assert that the role of norms in creating shame or guilt in Japan differs from its corresponding role in Western cultures. See, e.g., Takie Sugiyama Lebra, Shame and Guilt: A Psychocultural View of the Japanese Self, 11 ETHOS 192, 192–94 (1983). Accordingly, an esteem-based sanction may have a different impact in Japan than in a Western state. Likewise, the effectiveness of laws transferred from one state to another may depend on extralegal conditions, such as the relative impact of norms, in the receiving state. See Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, Economic Development, Legality, and the Transplant Effect, 47 EUR. ECON. REV. 165, 167 (2003) (examining the "transplant effect" of adopting one state’s laws in another without adaptation to local conditions).

See Barry Eichengreen, Taming Capital Flows, 28 WORLD DEV. 1105, 1113 (2000) (Committee’s use of peer pressure); Cynthia C. Lichtenstein, Introductory Note, Bank for International Settlements: Committee on Banking Regulations and Supervisory Practices'
informal means of regulating member conduct are no less effective because of their informality. Even though Committee decisions do not have legal effect, in practice they are understood to bind those national authorities represented among the Committee’s membership.

Sanctioning may also be supported by reciprocal fairness—that is, the tendency of people to respond more cooperatively to friendly actions than a rational choice model would predict and to be more vengeful in response to hostile actions. The risk of costly sanction may be a strong deterrent to those considering deviating from a group norm.

Reputation may also reinforce network norms. Acting consistently with norms-based expectations may enhance a member’s network

Consultative Paper on International Convergence of Capital Measurement and Capital Standards, 30 INT’L. MATERIALS 967, 969 (1991) (“One imagines that considerable peer pressure is applied to any regulator refusing to go along with the consensus.”).

61. “No punishment is levied for failing to establish laws that implement the [Accord], and no rewards are proffered for implementing them. Nothing, that is, other than the ability to participate with comfort in the continuing meetings of the [C]ommittee and to be recognized as a country that meets standards established by the major commercial nations of the world. That seems to be sufficient.” Robert E. Barnett, How Peter Cooke Sowed the Seeds of Global Regulation and Supervision, THE BANKERS, Nov./Dec. 1992, at 70.

62. See Basel Committee on Banking Supervision, History of the Basel Committee and its Membership 1 (Oct. 2004), http://www.bis.org/bcbs/history.pdf [hereinafter History of the Basel Committee] (“Committee... conclusions do not, and were never intended to, have legal force.”).


65. Scott and Stephan argue that international elites are more likely to favor reciprocal fairness, having survived a “selective process in which perceptions of weakness are not rewarded. Even where advancement depends on convincing superiors of servility, the supplicant still must present a credible image of mastery of his inferiors.” Scott & Stephan, supra note 7, at 618. Thus, elites are likely to be concerned about developing a reputation for weakness and be willing to incur greater costs to punish those who treat them unfairly. Id. Yet not all network elites possess those characteristics, and, in fact, they may be discouraged among senior regulators in some states. See, e.g., Jong S. Jun & Hiromi Muto, The Hidden Dimensions of Japanese Administration: Culture and Its Impact, 55 PUBL. ADMIN. REV. 125, 126 (1995) (describing reciprocal junior-senior relationships in Japanese bureaucracies). A willingness to incur greater costs in punishing, however, may be appropriate where a counterparty’s breach signals defection from a broader network norm. In that context, the counterparty may be considered to have defected from the network as a whole, with a corresponding increase in the aggregate costs members are willing to bear to punish her. See Lisa Bernstein, Private Commercial Law, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 108, 111 (Peter Newman ed., 1998) (“When market transactors share a common view about what constitutes acceptable commercial behaviour, a given instance of misbehaviour will result in more transactors imposing the sanction.”). Cultural differences that vary the impact of norms-based compliance, see supra note 59 and accompanying text, may become less relevant to the extent network norms create a common frame of reference for network members.

reputation, increasing her influence within the group; conversely, deviating from a norm may result in reputational loss.67 Thus, even when a member has a significant upfront incentive to defect, longer term gains from cooperation (or losses from defection) may tip the balance in favor of cooperation.68 A bank regulator whose country fails to comply with the Accord, for example, is likely to suffer a loss of reputation and influence among network peers,69 which may in turn impair her future career opportunities and her effectiveness in representing her state’s interests before other network members.70 That impact may extend beyond network members to other, senior domestic actors involved in a state’s decision to defect.71 Accordingly, sanctions resulting from a failure to comply with a network norm may be three-fold: to the network member personally; to the domestic regime with which she is associated; and to the state she represents.

Group standing is particularly important where, as in the banking industry, the group includes dominant actors in the field. The Federal Reserve Board and the Bank of England, for example, are driving forces on the Basel Committee and represent some of the largest financial markets in the world.72 Committee membership may facilitate access to senior regulators in those markets, as well as provide insight into regulatory and market changes. Consequently, even where a central authority to enforce norms is absent, disaggregated group membership and repeated interaction provide other means of control that can prove just as effective.73

67. See Robert Axelrod, An Evolutionary Approach to Norms, 80 AM. POL. SCI. REV. 1095, 1107–08 (1986); Sunstein, Expressive Function, supra note 22, at 2032.
68. Guzman, supra note 12, at 1847–50.
69. Id. at 1881.
70. The impact of network standing on careers—and, in turn, the impact of network norms and reputation on individual action—should not be underestimated. Noted one U.S. trade negotiator, “‘What I want to know if I negotiate with someone is: what ministry are you from and what it takes for you to get promoted.’” BRAITHWAITE & DRAHOS, supra note 43, at 496.
71. See Scott & Stephan, supra note 7, at 584. A subsequent change in leadership, resulting from the normal replacement of one political party with another, is unlikely to alter that reputation. Id. at 584–85.
72. See Zaring, Informal Procedure, supra note 20, at 571. See also Beth A. Simmons, The International Politics of Harmonization: The Case of Capital Market Regulation, 55 INT’L ORG. 589, 595–96 (2001) (stating that global financial regulation is notable for its dominance by the U.S. markets), 601–05 (using the Accord as an example of market-based incentives that encourage regulatory convergence supported by a dominant financial center).
73. See Aviram, supra note 41, at 1227 (“The greater the network benefits, the greater the value conferred on the network member, and therefore the greater the cost of canceling the membership in the network.”). An important member of a network may be less threatened by a risk of exclusion or decline in status if the network benefits from her membership. Id. Group status, nevertheless, may be important to members who value the esteem of their foreign counterparts over their superiors at home. A regulator’s loyalty to her peers may increase as a result
Domestic elites may also recognize (and network members will have incentives to cause them to recognize) that rejection of a network norm will result in sanctions that limit the effectiveness of a state's representatives among peer regulators. If the impact is significant, those representatives may have an incentive to implement that portion of a norm which results in minimal sanction—weighing the costs and benefits of adoption against those of defection. Resulting state compliance may then reflect a balance between network benefits/sanctions on the one hand and competing domestic interests on the other, complementing the transnational legal process model that Koh describes.

The creation of a network norm, however, may not result in actual compliance at the state level. It may simply result in a consensus among network members, and network members only, about what should be done. As the following section explains, network norms may imbue a network member's actions with a particular meaning or clarity of purpose within the network. Actual state compliance with a network norm, however, may depend on politicians, bureaucrats, and others "outside" the network who do not view compliance in the same light.

74. Consider the two-level game metaphor for international negotiations. Two-level games model the interaction between negotiations at the national and international levels and illustrate how the interests of a negotiator may diverge from those of her domestic constituents. Robert D. Putnam, Diplomacy and Domestic Politics: The Logic of Two-Level Games, 42 INT'L ORG. 427, 456–59 (1988). A negotiator, for example, may influence her state's domestic agenda, in a way not otherwise possible at home, through agreements she reaches internationally. Id. at 457. Likewise, in the exercise of discretion, a senior regulator may agree with her foreign counterparts to implement standards that are inconsistent with certain domestic interests. In U.S.-Japanese trade negotiations, for example, gaiatsu (foreign pressure) by U.S. representatives, pursuing interests aligned with those of some Japanese constituencies, may have provided the "excuse" for domestic actors to cause change over the objection of other local parties. See Leonard J. Schoppa, Bargaining with Japan 301 (1997).

75. Koh's description does not directly address the coercive effect of norms on state compliance and so may be most apt where there already exists a domestic environment that supports the relevant international norm. See George W. Downs, David M. Rocke & Peter N. Barsoom, Is the Good News About Compliance Good News About Cooperation?, 50 INT’L ORG. 379, 387 (1996) (suggesting that, in many cases, international commitments may reflect, rather than influence, how states choose to act).

76. See Jeffrey T. Checkel, Norms, Institutions, and National Identity in Contemporary Europe, 43 INT’L STUD. Q. 83, 84 (1999) (“[D]omestic norms and domestic structure are variables that intervene between systemic norms and national-level outcomes.”); Haas, supra note 24, at 46–49 (suggesting that domestic political costs may affect levels of compliance); Scott & Stephan, supra note 7, at 583 (proposing that the ability of political elites to pursue self-interested goals is affected by domestic government characteristics).
Those differences may influence which norms are integrated, how they are integrated, and whether the integration is successful.\textsuperscript{77}

2. Norms and Signaling

The specific standards set out in the Accord support, and in turn are supported by, abstract norms of cooperation among global regulators. Richard McAdams' dichotomy between “abstract” and “concrete” norms helps describe this relationship. As McAdams explains, abstract norms broadly define appropriate behavior, such as “friends should be loyal.” Concrete norms, in turn, provide narrow direction on what actions satisfy that abstract norm, such as listening attentively to a friend’s troubles, watering her plants when she is away, or driving her home when she is intoxicated.\textsuperscript{78} Each set of norms reinforces the other: abstract norms provide the framework within which concrete norms are introduced and understood, and concrete norms demonstrate and define abstract norms among network members.\textsuperscript{79}

A preexisting norm of cooperation among regulators has provided states with a strong incentive to enter into global instruments like the Accord.\textsuperscript{80} As one senior Federal Reserve official observed, Japan’s regulators adopted the Accord because “‘they realize[d] it [was] in their longer-term interest to be viewed as a cooperative member of the international community.’”\textsuperscript{81} Diplomatic professionals also see regulatory cooperation as an end in itself and support agencies willing to enter into instruments like the Accord because doing so reinforces cooperation among global regulators.\textsuperscript{82}

Consequently, using McAdams’ formulation, we can understand an action such as implementing the Accord to be perceived among global regulators as a concrete expression of an abstract network norm: the Accord supports cooperation by reinforcing levels of interaction among network members and is itself supported by an international norm of

\textsuperscript{77} See Checkel, supra note 76, at 86–90.

\textsuperscript{78} McAdams, supra note 11, at 382.

\textsuperscript{79} Id. at 383–84. See also Eisenberg, supra note 11, at 1276–78 (describing “concretization” of normative standards).

\textsuperscript{80} Macey, supra note 34, at 1373–74. As Abram Chayes and Antonia Handler Chayes have described, states “must submit to the pressures that international regulations impose.” Failing to do so may affect future relationships and good standing among peer nations, a “critical factor” in ensuring compliance with international agreements. CHAYES & CHAYES, SOVEREIGNTY, supra note 8, at 27 (citation omitted).

\textsuperscript{81} Solomon, supra note 50, at 424 (quoting an undisclosed senior Federal Reserve official).

\textsuperscript{82} Macey, supra note 34, at 1373–74 (“Cooperation in the international sphere is a form of global social norm.”).
cooperation. Implementing the Accord may signal a network member’s willingness to cooperate with others and, in turn, be tied to network standing, status, and self-esteem in ways that would not occur outside the network. In that respect, a network norm can give particular meaning to concrete actions by attaching new values to them—with the result that network members are induced to behave consistently with that norm or risk sanction for failing to do so.

Since norms may vary from network to network, the impact on reputation of an action within one set of network norms may not be the same

83. This analysis may better explain the “implicit” state obligations that Andrew Guzman has observed. Using the Accord as an example, Guzman posits that a state may suffer reputational damage if it deviates from a standard with which it has complied for a number of years, even where that standard is nonbinding, on the theory that others have come to rely on that compliance. Guzman, supra note 12, at 1863–64. While a reliance explanation may apply to states with large financial markets, it is less convincing in the case of less financially significant states. Using this Article’s analysis, a state may instead be understood to adopt the Accord in order to signal cooperation to others, consistent with abstract and concrete norms developed among network members. Later defection, irrespective of market size, may signal to others a failure to cooperate, with resulting network sanctions (including a loss of status and reputation), irrespective of the Accord’s legally nonbinding status.

84. See ERIC A. POSNER, LAW AND SOCIAL NORMS 18–27 (2000) [hereinafter POSNER, LAW/SOCIAL NORMS].

85. See Sunstein, Social Norms, supra note 11, at 925–27 (”The meaning of acts is very much a function of context and culture.”). The South African investor boycott of the mid-1980s offers a real-world illustration of how similar actions can communicate different information to different people. Calls for stockholders to sell shares of companies doing business in South Africa and subsequent investor activism are often credited with the demise of South African apartheid. In fact, while investor boycotts brought substantial, usually unwanted, attention to companies doing business in South Africa, the effects of that pressure on stock prices were fairly modest. See William H. Kaempfer, James A. Lehman & Anton D. Lowenberg, Divestment, Investment Sanctions, and Disinvestment: An Evaluation of Anti-apartheid Policy Instruments, 41 INT’L ORG. 457, 460–64 (1987); Siew Hong Teoh, Ivo Welch & C. Paul Wazzan, The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott, 72 J. Bus. 35, 38–39 (1999). A company’s decision to do business in South Africa may not have communicated the same information to all investors—for some, doing business in South Africa may have raised questions about management responsibility; and, for others, doing business in South Africa may have evidenced management opportunism and corporate stability (or provided no information at all). Consequently, the downward pressure on share prices from sales by activist investors was largely offset by purchases by others. Id. at 77.

86. Sunstein, Expressive Function, supra note 22, at 2022 (“The social meanings of actions are very much a function of existing social norms.”). Robert Jervis’s insights are also relevant here. See ROBERT JERVIS, THE LOGIC OF IMAGES IN INTERNATIONAL RELATIONS 18, 21, 66 (1970) (defining signals as words or actions intended to influence perceptions that can be sent by both deceptive and honest states). As Jervis notes, “signals depend for their effectiveness on agreement, usually implicit, as to the meanings of particular behaviors. Signals are not natural; they are conventional. That is, they consist of statements and actions that the sender and receiver have endowed with meaning in order to accomplish certain goals.” Id. at 139.

87. See Sunstein, Social Norms, supra note 11, at 917–18; Posner, Inefficient Norms, supra note 11, at 1699–1701.
in a different network. The analysis in this Article suggests that variations in a state’s reputation may reflect differences across networks in member composition, network relationships, and norms that affect what information a particular action signals. For example, states may demonstrate varying levels of compliance with international agreements, but deviation in one field (such as the environment) may not affect a state’s network relationships in another (such as trade).

When compliance with a network standard imposes opportunity or other costs, the act of complying may communicate to network members a state’s willingness to forego short-term gains in favor of longer-term cooperation. Simply adopting a standard, however, may cost little, particularly when monitoring and independent enforcement are kept to a minimum. More significant, in those circumstances, may be a member’s decision not to adopt a network norm. Among network members,

88. See Jervis, supra note 86, at 141 (“[F]or these or any other distinctions to be significant for signaling they must be salient for both parties. It may be difficult to be sure what is obvious to another, especially when he does not share your history, values, norms, and theories . . . .”).

89. See Sunstein, Expressive Function, supra note 11, at 2040. David Moore posits that a state looking for a long-term supply of agricultural imports is more likely to enter into an agreement with a state that observes international human rights standards, since doing so signals a lower discount rate and greater propensity to cooperate in the longer term. Moore, supra note 16, at 886–87. However, states are not unitary, and different actors (for sender and receiver) may interpret similar actions in different ways. Thus, an action that signals cooperation in one network (for example, in human rights) may not necessarily have the same meaning in another (for example, in trade). See also Elmer J. Schaefer, Predicting Defection, 36 U. Rich. L. Rev. 443, 462–63 (2002) (“The ability to comply with a norm and the importance of doing so will vary from norm to norm and from situation to situation.”). Of course, states may tie the two together, for example, by imposing trade sanctions as a means to punish defection from a human rights norm, but that would be less the result of reputational impact in a non-human rights area and more a reflection of the other states’ strategy of linking issues to punish a defector. See David W. Leebron, Linkages, 96 AM. J. INT’L L. 5, 12–15 (2002) (describing strategic linkage of issues and sanctions).


91. See id. at 109 (“[E]xamples of a state’s defection from an agreement in one area (for example, environment) jeopardizing its reputation in every other area (for example, trade and security) are virtually nonexistent in the literature.”). But see Colin B. Picker, Reputational Fallacies in International Law: A Comparative Review of United States and Canadian Trade Actions, 30 BROOK. J. INT’L L. 67, 106–10 (2004) (Overarching state reputations may spill over into the minds of officials, who believe it represents a state “better than their individual perceptions based on a limited level of interaction.”).


93. Id. at 902–04. This is not always the case. For Japan, adopting the Accord was costly, since it introduced a new form of banking regulation. See infra note 157 and accompanying text.

94. See Posner, Law/Social Norms, supra note 84, at 189–90 (“[I]f [a] seller tells you that he sometimes cheats, while all other sellers deny ever cheating, you might as well take your chances with another seller.”); Lessig, Social Meaning, supra note 11, at 998 (point-
that action may signal the defecting state’s unwillingness or inability to cooperate, perhaps due to its unique position or strongly held political preferences.\textsuperscript{95} Accordingly, states have strong incentives to accede to a network standard, even when actual compliance is lower.\textsuperscript{96} Dissident activity, if it occurs, is more likely to take place outside of public view.\textsuperscript{97}

To be credible, however, a signal must be costly or otherwise capable of separating those who support a network standard from those who do not.\textsuperscript{98} If implementing the standard costs little, the pool of states signaling support for that standard may include both compliers and mimickers.\textsuperscript{99} That signal will become more credible to the extent that others can observe later compliance (or defection)\textsuperscript{100}—a greater probability of verification will increase the associated signaling costs, differentiating complying states that are willing to incur those costs from mimicking states that are not.\textsuperscript{101} Yet, for a signal to be costly, a state may not be required to incur expenditures up front. A risk of future expense, or future sanction in the event of noncompliance, may be sufficiently costly to differentiate those who can credibly signal support from those who cannot.\textsuperscript{102}

3. Norms and Levels of Compliance

As noted earlier, network relationships have become increasingly important for the world’s regulators, facilitating increased levels of

\begin{itemize}
  \item \textsuperscript{95} SLAUGHTER, supra note 1, at 182.
  \item \textsuperscript{96} Moore, supra note 16, at 903.
  \item \textsuperscript{97} Sunstein, Social Norms, supra note 11, at 924.
  \item \textsuperscript{98} POSNER, LAW/SOCIAL NORMS, supra note 84, at 19–20; Moore, supra note 16, at 883–84, 903. A familiar example is the use of education to signal employee productivity. Obtaining an education can be costly in terms of money, time, and effort. People who are highly productive, however, may find obtaining an education to be less costly and so more readily incur that cost, credibly signaling their productivity to prospective employers. Jack L. Goldsmith & Eric A. Posner, Moral and Legal Rhetoric in International Relations: A Rational Choice Perspective, 31 J. LEGAL STUD. 115, 123–24 (2002); Moore, supra note 16, at 883.
  \item \textsuperscript{99} Moore, supra note 16, at 903.
  \item \textsuperscript{100} Whether a state is observed to defect from a standard may result from monitoring, as a by-product of other activity, or may be due to the state’s actions being observable at minimal cost. McAdams, supra note 11, at 361–62.
  \item \textsuperscript{101} POSNER, LAW/SOCIAL NORMS, supra note 84, at 190–92.
  \item \textsuperscript{102} In that respect, the costs associated with a network signal may differ from those in the education paradigm used by others, more closely resembling the signal associated with a money-back guarantee. See Sridhar Moorthy & Kannan Srinivasan, Signaling Quality with a Money-Back Guarantee: The Role of Transaction Costs, 14 MARKETING SCI. 442, 443–44 (1995). Upfront expenditures are minimal in the case of money-back guarantees. Nevertheless, a lower quality seller is more likely over time to incur greater transaction costs than a higher quality seller. Recognizing this, she is less likely to offer a money-back guarantee in the first place, providing buyers with a credible signal of product quality. Id. at 464.
\end{itemize}
interaction and long-term relationships among senior regulators in different countries who seek to keep pace with the growing globalization of the industries they oversee. Relational theory posits that parties in a long-term relationship are more likely to value that relationship over individual differences, developing norms of exchange and entering into flexible agreements whose terms may be varied over time as circumstances change. It should be no surprise, then, that many of the informal international instruments entered into among regulators, sometimes known as "soft law" agreements, reflect relational characteristics.

Soft law instruments, like relational contracts generally, tend to be drafted flexibly, allowing for the modification of performance over time based on the parties' mutual expectations and changing circumstances. Flexibility is a key feature, "permit[ting] a step forward because [the agreements] do not prevent steps backward." Norms and the parties' relationships develop, serving as a foundation for future agreements.

103. See supra notes 33–34 and accompanying text.
106. See Edith Brown Weiss, Understanding Compliance With International Environmental Agreements: The Baker's Dozen Myths, 32 U. RICH. L. REV. 1555, 1570 (1999) (noting the relevance of relational analysis to legally nonbinding agreements). International law scholars have also long recognized the relevance of relational theory to treaty compliance. See Anthony D'Amato, The Path of International Law, 1 J. INT'L LEGAL STUD. 1, 12 n.8 (1995) (noting that "[t]he 'relational' theory of contracts has a lot to learn from treaties" as well).
108. Frieder Roessler, Law, De Facto Agreements and Declarations of Principle in International Economic Relations, 21 GER. Y.B. INT'L L. 27, 54 (1978). Soft law instruments also provide procedural benefits to regulators, including the ability to enter into agreements without legislative approval or public notice. AUST, supra note 105, at 35–38; Gruchalla-Wesierski, supra note 105, at 41–43.
practices over the life of the relationship become essential to defining their respective obligations.\textsuperscript{109} Focusing on only the terms of an instrument, without also considering these norms, "underestimate[s] the practical obligations imposed by relational forces."\textsuperscript{110} Enforcement also depends on the relationship's importance to the parties. Due to the importance of networks, regulators generally decline to risk network sanctions that may impair their relationships.\textsuperscript{111} Consequently, as noted earlier, Committee members consider the Accord and other Committee decisions to be binding obligations despite their legally nonbinding status.\textsuperscript{112}

A relational approach suggests that network norms may vary the terms of agreements among regulators. Accordingly, a state may deviate from the black letter of a network standard without being considered a defector, so long as its actions are consistent with the understanding of network members.\textsuperscript{113} These members may permit deviation under circumstances that are not fully set out in the instrument or apparent to

\begin{footnotesize}
\begin{enumerate}
\item[110.] Smith, \textit{supra} note 64, at 1587.
\item[111.] In general, international regulators take soft law agreements seriously. See \textit{Louis Henkin, How Nations Behave} 56 (1968); Gold, \textit{supra} note 105, at 443. They rely on these agreements to create "moral" or "political" commitments that agreement terms will be mutually respected. See Oscar Schachter, \textit{The Twilight Existence of Nonbinding International Agreements}, 71 AM. J. INT'L L. 296, 304 (1977); Gruchalla-Wesierski, \textit{supra} note 105, at 46–48. Failing to comply risks lowering the "credit-rating" of the relevant government or ministry and upsetting existing cooperation. Baxter, \textit{supra} note 105, at 556. It may also result in political or other sanctions, such as reciprocal noncompliance by the non-breaching party or a refusal to cooperate on other matters. AUST, \textit{supra} note 105, at 39; Marian Nash (Leich), \textit{Contemporary Practice of the United States Relating to International Law}, 88 AM. J. INT'L L. 515, 517–18 (1994) (quoting a memorandum by the U.S. State Department Assistant Legal Adviser for Treaty Affairs).
\item[112.] See \textit{supra} notes 60–63 and accompanying text.
\item[113.] The pre-World War I gold standard, for example, reflected norms that evolved among Europe's central bankers and capital markets investors. That standard, evidenced by unwritten "rules of the game," was intended to peg the value of the world's principal currencies to a fixed weight of gold, effectively linking them through a fixed exchange rate. Ronald I. McKinnon, \textit{The Rules of the Game: International Money in Historical Perspective}, 31 J. ECON. LIT. 1, 3–6 (1993). Over time, capital markets investors came to see adherence to the gold standard as a signal of financial and political stability, in effect a "good housekeeping seal of approval" that evidenced a state's commitment to limited currency intervention. Michael D. Bordo & Hugh Rockoff, \textit{The Gold Standard as a “Good Housekeeping Seal of Approval"}, 56 J. ECON. HIST. 389, 390–91 (1996). Central bankers and investors, however, came to recognize specific cases of emergency that excused deviation. Those circumstances included war, financial crisis, and shocks to the terms of trade. After a return of normalcy, states were required to return to gold convertibility. \textit{Id.} at 392–94. Those that deviated in accordance with the rule generally were not penalized. States that deviated outside the scope of the rule, however, were understood to no longer comply and risked sanction (for example, by investors who later declined to buy their debt). \textit{Id.} at 393.
\end{enumerate}
\end{footnotesize}
actors outside the network. Reactions to that deviation may differ—with network members understanding that less-than-full compliance still signals support of the relevant norm, even when others outside the network see it as a defection. Particular behavior that evidences an abstract norm may evolve over time as the costs and benefits of that behavior change—thus affecting, in the case of regulatory networks, which standards evidence network cooperation (such as the Accord) and which levels of compliance are acceptable to network members. If this is accurate, then traditional concepts of “compliance” may not apply internationally; rather, what constitutes compliance may vary across networks and over time, reflecting differences in norms.

C. Principal Implications

This Article’s new approach to understanding state compliance posits that network norms may influence the outlook of senior regulators, affecting the actions they take on behalf of states and, in turn, impacting levels of state compliance. Norms also provide particular meaning to a member’s actions that may or may not be understood by those outside the network, signaling support of a network norm to members even when actual compliance with the black letter is lower.

This new approach has a number of important implications. It suggests that, in certain circumstances, network forces which affect state action may permit levels of compliance that differ from those understood by actors outside the network. Differences in perspective may result in network members understanding compliance or defection from a global standard differently than, for example, market actors—who may impose market costs even in the absence of regulatory network sanction. It also

114. See Bilder, supra note 48, at 69 (Officials may regard failure to comply completely with a global standard as “tacitly understood by all the participants as part of their joint expectational framework.”).

115. See McAdams, supra note 11, at 383–85.

116. As Richard Bilder has noted, the understanding among officials that a failure to comply is not a breach may make “attempts to analyze their behavior in terms of formal notions of ‘compliance’ . . . unsatisfactory indeed.” Bilder, supra note 48, at 69. Chayes and Chayes have also noted, in the international arena, that “acceptable” compliance may differ from full compliance, “reflect[ing] the perspectives and interests of the participants in an ongoing political process, rather than some external, scientifically or market-validated standard.” CHAYES & CHAYES, SOVEREIGNTY, supra note 8, at 17, 19–20. See also Chayes & Chayes, On Compliance, supra note 1, at 201 (asserting that “the ‘acceptable level of compliance’ is subject to broad variance across regimes, times, and occasions”).

117. Beth Simmons has considered the role of market forces in state compliance, positing that compliance in some instances may be enforced by competitive market forces. State compliance with an IMF standard, in her illustration, signaled a commitment to current account policy liberalization to those companies potentially willing to do business in that state. States that failed to comply risked the possibility of market actors doing business elsewhere.
suggests norms may permit members to vary compliance with network standards, potentially resulting in inconsistent levels of compliance.\textsuperscript{118} Unless enforcement is uniform, the practical implementation of standards may vary from state to state. Japan's experience with the Accord, described in the next Part, provides some illustration.\textsuperscript{119}

This approach also highlights potential conflicts between a global regulator's role as a state representative and her status as a member of a regulatory network. As national representatives, regulators are expected to pursue state interests at the international level.\textsuperscript{120} Compliance with a network norm, however, may raise a regulator's status among her network peers, even (or particularly) when it competes with domestic interests—potentially causing a conflict between a regulator's state responsibilities and her network interests.\textsuperscript{121} As network members, regulators are also expected to implement and enforce network standards at home.\textsuperscript{122} Competing domestic interests, however, may influence how those standards are implemented and enforced, with actual application varying from state to state. Greater oversight at the domestic level may balance some of these competing factors,\textsuperscript{123} but the potential for conflict—and resulting variations in compliance—underscores the need to


\textsuperscript{119} National variations in compliance may be particularly complex for multinational companies subject to supervision by multiple regulators in different jurisdictions. \textit{See The New Basel Accord: Sound Regulation or Crushing Complexity?: Hearing Before the Subcomm. on Domestic and International Monetary Policy, Trade, and Technology, H. Comm. on Financial Services}, 108th Cong. 70–71 (2003) [hereinafter \textit{The New Basel Accord}] (comments by D. Wilson Ervin, Managing Director and Head of Strategic Risk Management, Credit Suisse First Boston).

\textsuperscript{120} See Singer, \textit{supra} note 34, at 532–33, 535 (noting that legislators and financial regulators are engaged in a principal-agent relationship, with regulatory discretion constrained by the preferences of elected officials).

\textsuperscript{121} See \textit{Braithwaite \& Drahos, supra} note 43, at 462–63 ("[D]iplomatic demonstrations of independence from the economic interests of their own firm" may enhance network reputations of industry engineers developing global standards.).

\textsuperscript{122} See Benedict Kingsbury, Nico Krisch \& Richard Stewart, \textit{The Emergence of Global Administrative Law}, 68 LAW \& CONTEMP. PROBS. 15, 36 (2005) (Procedures developed by global regimes seek to "place domestic regulatory bodies and officials in an additional role as agents of the relevant global regime, and seek to make them in some way responsible for compliance with it.").

\textsuperscript{123} Note, in this regard, U.S. legislative efforts to require U.S. bank regulators to come to a consensus on positions to be taken at the Basel Committee and, if no consensus can be reached, to defer to the Treasury Secretary. Zaring, \textit{Informal Procedure, supra} note 20, at 598–99.
consider more closely the growing body of international administrative law and procedure and new scholarship in this area.124

II. THE BASEL ACCORD AND JAPAN’S EXPERIENCE

In this Part, I briefly summarize the Accord’s history and Japan’s experience in complying with its standards and then use that summary to illustrate the relationship among international norms, signaling, and compliance in line with this Article’s analytical approach.125

Japan’s compliance with the Accord has been checkered—although initially considered by Japan’s regulators and bankers to impose manageable costs, compliance became increasingly difficult as Japan’s economy weakened.126 Nevertheless, implementing the Accord’s minimum standard (an 8% ratio of capital to risk-weighted assets) has signaled to other financial regulators Japan’s willingness to cooperate globally, even where its overall compliance with the black letter of the Accord has been lower. As Japan’s experience indicates, failing to implement a network standard may result in network sanctions, providing members with strong incentives to send the “right” signal. Japan’s experience may also illustrate how network norms can allow for lower levels of compliance to be accepted by network members under certain circumstances.

A. The Basel Committee and the Accord

Global bureaucrats are increasingly coordinating the formulation and implementation of national financial standards and regulation, reflecting the growing interdependence of the world’s financial markets127 and the potential cross-border impact of banking and other financial crises.128 As

---

124. See Kingsbury, Krisch & Stewart, supra note 122, at 14–28 (defining the scope of global administrative law, its sources, institutional mechanisms through which it is being applied and developed, and emerging principles and tools).

125. A complete analysis of the factors that affected Japan’s banking industry, and later decision to recapitalize its banks, is beyond the scope of this Article. My analysis here is limited to those points that illustrate the importance of norms and signaling in network relationships and compliance.


128. Picciotto, supra note 5, at 1045–46.
a result, a "consensus" on global standards and codes of conduct aimed at achieving increased financial stability and stronger financial systems is developing among regulators. Much of this coordination has been evidenced by legally nonbinding, "soft law" instruments among global bureaucrats.

A showpiece of soft law coordination, the Accord was finalized in 1988, with effect from 1992 (for Japanese banks, from March 1993, the end of their fiscal year), under the auspices of the Basel Committee. The Committee's principal purpose has been to foster international cooperation on supervisory standards, practices, and guidelines for banks, supporting a gradual convergence towards common regulation and approaches to supervision. The Committee also works to improve contacts among global banking regulators, acting as a joint decision-making body, a forum for the exchange of information, a means of coordinating activities, and a place to develop senior regulatory relationships.

Committee organization is fluid and informal, partly reflecting its broad and flexible constitution as a body of regulators instead of states. Decisions are made by consensus, rather than through a formal one state/one vote process, often permitting regulators from the wealthiest members to play a greater role in developing Committee standards. In addition, "an important, though necessarily unpublicised, element in the Committee's regular work" is the development of close personal contacts among regulators in different countries. These relationships are fostered, in part, through the exclusive nature of Committee membership—

132. Porter, supra note 73, at 56-57, 72-73; Hayward, supra note 5, at 790-91. Until recently, the Committee sponsored educational conferences for regulators from around the world in order to enhance relations and promote the globalization of Committee standards. See History of the Basel Committee, supra note 62, at 4-5. In addition, the Committee coordinates with securities and insurance regulators internationally through the Joint Forum established in 1996. See BIS, Joint Forum, http://www.bis.org/bcbs/jfabout.htm (last visited Mar. 18, 2006). Committee members also interact through overlapping membership in other organizations. See supra notes 45-47 and accompanying text.
133. Zaring, Informal Procedure, supra note 20, at 569-70.
134. Zaring, Other Means, supra note 45, at 302, 322-23.
135. History of the Basel Committee, supra note 62, at 5. "As one regulator put it, 'The most important document to flow from the [Committee] was the telephone book of all the involved regulators.'" Barnett, supra note 61, at 69.
limited publicity, meetings that are closed to the public, and restrictions on membership.\textsuperscript{136}

The Committee has also sought to avoid publicity, preferring to remain in the "‘hidden secret world of the supervisory continent.’"\textsuperscript{137} That secrecy is itself remarkable, allowing the Committee to deliberate free from outside pressures while suggesting a high degree of institutional control over individual members.\textsuperscript{138}

The Accord was the product of negotiation among Committee members,\textsuperscript{139} spurred by a bilateral U.S.-U.K. accord (later including Japan) that was aimed both at overcoming resistance to a common capital standard and blocking a competing standard in the European Community.\textsuperscript{140} Neither the Federal Reserve Board nor the Bank of England demanded that other states accede to their agreement.\textsuperscript{141} Nevertheless, deliberation by other Committee members took place under the very long shadow of the U.S.-U.K. alliance. After Japan joined, it became clear that members needed to strike an agreement quickly or risk having the world’s principal financial markets announce standards to which they were not a party.\textsuperscript{142}

The Accord was hailed as one of the most important events in the coordination of international banking regulation.\textsuperscript{143} Considered to be "more robust and effective" than many international treaties,\textsuperscript{144} over 100

\begin{footnotes}
\footnote{136. Norton, supra note 5, at 260 (conjecturing that Committee exclusivity has added to its potency); Zaring, Informal Procedure, supra note 20, at 555–56 (citing the Committee’s lack of publicity and limited public access).}
\footnote{137. Porter, supra note 73, at 66 (quoting a former Committee chairman). Perhaps in order to enhance the legitimacy of its decisions, the Committee has started to circulate them publicly and also welcome public comment on its proposals. Zaring, Informal Procedure, supra note 20, at 556–57.}
\footnote{138. Porter, supra note 73, at 66. See also id. at 80 ("The Committee’s esprit de corps is an indication of a high degree of peer socialization.").}
\footnote{139. Freeland, supra note 63, at 233.}
\footnote{140. Kapstein, Global Economy, supra note 22, at 113. Initial work in Europe on capital adequacy started about a decade earlier. Porter, supra note 73, at 64.}
\footnote{141. Secret coordination, however, among the United States, the United Kingdom, and (eventually) Japan was seen by some as a "bombshell" that crippled the cooperative spirit that had developed among Committee members. Porter, supra note 73, at 68.}
\footnote{142. Kapstein, supra note 22, at 115. See also James K. Sebenius, Challenging Conventional Explanations of International Cooperation: Negotiation Analysis and the Case of Epistemic Communities, 46 Int’l Org. 323, 345–46 (1992) (stating that the U.S., U.K., and Japanese coalition shaped the perceived zone of possible agreement among other G-10 states and so strongly influenced the outcome).}
\footnote{144. Andrew Crockett, Thoughts on the New Financial Architecture, in Monetary Policy, Capital Flows and Exchange Rates: Essays in Honour of Maxwell Fry 78, 86 (2002) (At the time, Andrew Crockett was the General Manager of the BIS.).}
\end{footnotes}
states have adopted the Accord’s minimum 8% ratio of capital to risk-weighted assets. None of these states was obligated to do so—in fact, even though the Accord was endorsed by the G-10 central bank governors, it did not bind their respective governments, and in theory, any one of them could and can defect from the Accord at any time and for any reason.

Interpretation of the Accord has remained flexible, reflecting its relational nature and allowing for the adjustment of Accord standards in response to new problems. As a senior Committee member commented, “the primary objective of strengthening the capital of international banks took precedence over the letter of the [Accord]. Such a robust attitude would have been much more difficult to enforce had the agreement been drafted in precise legal language.” As a result, the Accord has relied on network relations and sanctions for enforcement (and, as necessary,
modification), as well as on social pressure—the commitment of members and the pressure that peers may exert in the event of breach.\footnote{149}

Notwithstanding its success, the Accord has raised some concerns. Even before taking into account the somewhat arbitrary selection of 8% as the Accord’s minimum requirement,\footnote{150} it is not clear that stringent capital regulation correlates closely with bank development, performance, or stability.\footnote{151} There is some evidence the Accord has increased international bank risk.\footnote{152} Some also claim its standards caused banks in the United States and Japan to reduce lending, contracting available credit\footnote{153} and weakening macroeconomic performance during the 1990s.\footnote{154} Discretion and national differences in implementing the Accord, as well as forbearance in enforcement, have also been handicaps.\footnote{155} Consequently, there are a number of substantive reasons why a state might consider foregoing adoption of the Accord. Still, the Accord’s standard is the acknowledged international benchmark of bank solvency, with 8%

\footnote{149} See supra notes 60–63 and accompanying text. Compliance with the Accord has been monitored by Committee members on an informal, decentralized basis. See Norton, supra note 5, at 241; Zaring, Other Means, supra note 45, at 290. The Committee periodically surveys members on their progress with implementation and has announced plans to assume a greater monitoring role in the future. Zaring, Informal Procedure, supra note 20, at 558.

\footnote{150} “That figure was seat-of-the-pants stuff,” admits Peter Cooke, the former Bank of England official who chaired the [Committee] that hammered out the [Accord] . . . .” David Fairlamb, Beyond Capital, Institutional Investor, Aug. 1994, at 42.


\footnote{155} For a description of Japan’s experience, see infra notes 175–189 and accompanying text.
being the minimum for international banks in the world's most financially developed economies and in over 100 others.156

B. Japan’s Experience

Or, is that really the case? For Japan, implementing the Accord was not without cost. The Accord’s focus on capital adequacy centered on the stability of individual banks—an approach at odds with Japan’s practices in the past, which had relied principally on government oversight over the entire banking industry. Consequently, the adoption of the Accord required Japan’s regulators to introduce a new approach to Japanese banking regulation.157

Japan, nevertheless, anticipated little difficulty in complying with the Accord when it was first announced in July 1988158—once it was agreed

156. BIS, G10 Central Bank Governors and Heads of Supervision Endorse the Publication of the Revised Capital Framework (June 26, 2004), http://www.bis.org/press/p040626.htm#pgtop. See also Guzman, supra note 12, at 1881 (“By 1992, most international banks in major industrial countries were in compliance.”); Daniel E. Ho, Compliance and International Soft Law: Why do Countries Implement the Basle Accord?, 5 J. INT’L ECON. L. 647, 668–70 (2002) (finding high levels of compliance, based on the binary response to the World Bank survey described in Barth, Caprio & Levine, infra note 243); Lee, supra note 105, at 6 (stating that the Accord’s methodology now applies to virtually all financial institutions worldwide); Simmons, supra note 72, at 604 (describing widespread adoption of Accord guidelines; “Even if these figures are exaggerated, they reflect an apparent desire to emulate the rules set forth by the G-10.”); Zaring, Informal Procedure, supra note 20, at 595 (“The Basle Accord . . . has enjoyed widespread compliance despite being putatively nonbinding.”).

157. Yoshimasa Nishimura, who was Deputy Director General (1989–1992) and later Director General (1994–1996) of the Banking Bureau of Japan’s Ministry of Finance when the Accord was implemented, later described differences in supervisory approach among Japanese, U.S., and European banking regulators. From Nishimura’s perspective, U.S. and European supervisors looked to enhance the stability of individual banks, whereas banking stability in Japan relied on overall regulatory administration of the financial system—commonly referred to as the “convoy system.” See Curtis J. Milhaupt & Geoffrey P. Miller, Cooperation, Conflict, and Convergence in Japanese Finance: Evidence from the “Jusen” Problem, 29 LAW & POL’Y INT’L BUS. 1, 8–9 (1997) (describing Japan’s historical convoy-style regulation and avoidance of bank failure). With adoption of the Accord, and its focus on individual bank capital, Nishimura found that “a financial system was no longer accepted in which stability was important and national support, through a [banking] license, was considered the foundation of trust in Japanese financial institutions.” While Japan had considered alternative styles of supervision, the Accord was the Ministry’s first experience in implementing a different form of regulation. YOSHIMASA NISHIMURA, NIHON NO KIN’YŪ SEIDO KAIKAKU [REFORM OF JAPAN’S FINANCIAL SYSTEM] 213 (2003) (translation).

158. Japan’s regulators and bankers initially were concerned that the Accord unfairly targeted Japanese banks in light of their global dominance and Japan’s lower capital requirements. See SOLOMON, supra note 50, at 424 (quoting an undisclosed Ministry of Finance official). As Nishimura noted, “[The global movement to introduce bank capital regulations] was not entirely directed against Japan’s financial activities, but it cannot be denied that one motivating factor was that U.S. and European countries could no longer tolerate the aggressive growth of Japanese banks in the overseas markets.” NISHIMURA, supra note 157, at 210 (translation). Some commentators have posited that the Ministry also used gaiatsu (foreign pressure) evidenced by the Accord to impose tighter capital requirements on, and so increase
that Japan's banks could count up to 45 percent of latent gains on securities holdings ("hidden assets") as Tier 2 capital.\textsuperscript{159} Japan's stock markets were booming, inflating the value of Japanese capital and allowing banks to raise new equity relatively inexpensively.\textsuperscript{160} Banks could satisfy Accord ratios by using existing assets, raising new capital in the public markets, or both. In light of Japan's economic prominence, Japanese bank regulators also looked to increase their cooperation with their foreign counterparts. Adopting the Accord was one way to signal this intention.\textsuperscript{161}

The costs of that signal skyrocketed 18 months later, in December 1989, when the Japanese stock market tumbled. Japan's banks were among the hardest hit.\textsuperscript{162} When the Accord was announced, analysts had estimated that "hidden assets" alone constituted 6 percent of regulatory capital for Japan's city banks and 9 percent for its long-term credit banks.\textsuperscript{163} The sudden drop in stock prices made it substantially more difficult for many banks to reach the Accord's minimums. Between March 1989 and March 1990, for example, the total value of just city bank "hidden assets" declined by approximately $50.5 billion.\textsuperscript{164} Within a matter of months, Japan's banks also lost up to 40 percent of their public market capitalization, handicapping their ability to access low cost equity.\textsuperscript{165}

Some Japanese bankers argued against fully implementing the Accord. Senior officials at the Ministry of Finance, Japan's principal financial regulator, cautioned against any amendment or delay, concluding that to do so could result in an international crisis of confidence in its authority over Japan's banking industry. See Colombatto & Macey, supra note 26, at 944; Kentaro Tamura, A Regulator's Dilemma and Two-level Games: Japan in the Politics of International Banking Regulation, 6 SOC. SCI. JAPAN J. 221, 25 (2003). A similar claim has been made with respect to the United States. See PORTER, supra note 73, at 70-71.

159.  KAPSTEIN, supra note 22, at 116; Tamura, supra note 158, at 234-35.

160.  KAPSTEIN, supra note 22, at 116.

161.  In describing why Japan acceded to the Accord, Nishimura explained, "It was necessary for Japan to actively promote international cooperation in bank supervision with the increasing international importance of its Tokyo market." NISHIMURA, supra note 157, at 211 (translation). Accession was also important because the Accord "was a symbol that the financial world had begun to globalize in the 1980s." Id. at 213 (translation).


Japan’s financial system. Reinforcing this resolve was the perception among global regulators that the Accord had “leveled the playing field” among states, preventing a jurisdiction from favoring its banks with lower capital requirements (and hence a pricing advantage) over banks in other jurisdictions. By adopting the Accord, Japan and its banks were perceived to be “play[ing] the game according to more generally accepted rules,” reinforcing Tokyo’s position as a global financial center.

Japan’s regulators also had an incentive to adopt the Accord to the extent that being seen to “play by the rules” supported public perception that the banking industry was financially stable. Moreover, an about-face refusal to adopt the Accord would have fueled concerns that Japan’s regulators were competing, not cooperating, with their foreign counterparts, potentially resulting in measures by the United States and others.

166. Tamura, supra note 158, at 235–36. See also Simmons, supra note 72, at 602 (states that fail to adopt standards developed by the dominant financial risk being perceived as “poorly regulated”).

167. Nishimura, supra note 157, at 211. As Hal Scott has noted, however, in light of preexisting differences in regulation and accounting and tax rules, “it would [have been] a total accident if the Accord did make the playing field more even.” Hal S. Scott, The Competitive Implications of the Basle Capital Accord, 39 ST. LOUIS U. L.J. 885, 886 (1995).

168. Japan’s lower capital ratios were considered one reason why Japanese banks had outperformed their U.S. and European peers. See Dayanand Arora, Japanese Financial Institutions in Europe 189–93 (1995); Nishimura, supra note 157, at 210–11. To illustrate those concerns, suppose that banks in state A have a 4% capital minimum and banks in state B have a 6% minimum. If the assets in Bank A and Bank B are comprised of identical loans, and shareholder returns are measured as returns on capital, then equal returns would mean that the return for Bank A must only be two-thirds of the return for Bank B. If returns are derived solely from interest charged on outstanding loans, then Bank A’s rates can be one-third less than Bank B’s to achieve the same rate of return. See Hal S. Scott & Shinsaku Iwahara, In Search of a Level Playing Field 5 (Group of Thirty, Occasional Paper No. 46, 1994). Bank A’s total lending capacity will also be greater than Bank B’s. Due to the difference in capital ratios, Bank A can lend up to 25 times its capital, whereas Bank B can only lend up to 16.66 times its capital. Id. at 5–6.

169. Editorial, Japan’s Role In World Finance, FIN. TIMES, May 12, 1988, at 22.

170. See Philipp Genschel & Thomas Plümper, Regulatory Competition and International Co-operation, 4 J. EUR. PUB. POL’Y 626, 636–37 (1997) (observing that although the Accord increased production costs, it was adopted by banks and regulators as a quick and credible means to signal a bank’s “soundness”). See also Mark J. Flannery & Joel F. Houston, The Value of a Government Monitor for U.S. Banking Firms, 31 J. MONEY, CREDIT & BANKING 14, 32–33 (1999) (pointing out that federal supervisory examinations may enhance bank market values).

171. There was U.S. precedent for those concerns. During the late 1800s and early 1900s, competition between U.S. federal and state regulators increased after adoption of the National Banking Act of 1864 and the emergence of a dual banking system. In order to make national bank charters more attractive, Congress agreed in 1900 to lower minimum bank capital requirements. Recognizing the potential impact on state bank charters, by 1909 all but one state (Massachusetts) that had capital requirements above the new federal level had reduced them in order to remain competitive. See Eugene Nelson White, The Political Economy of Banking Regulation, 1864–1933, 42 J. ECON. HIST. 33, 35–37 (1982).
to limit Japanese banking in their markets\textsuperscript{172} and risking rejection by the international financial community.\textsuperscript{173} Defection would also have impacted the effectiveness of Japan’s representatives on the Committee.\textsuperscript{174}

Faced with new capital requirements and a decreased ability to meet them, Japan’s banks began to introduce practices to defer the full recognition of reductions in capital. In many instances, they were assisted by Japan’s regulators—who refrained from fully enforcing Japan’s bank capital regulations during this period—in the false hope that the economy would soon recover and buoy the banking industry.\textsuperscript{175}

Among these practices was loan “evergreening,” which involved both the rollover of nonviable loans and the opening of new borrower credit lines to repay existing overdue loans so they would not be counted

\textsuperscript{172.} The Federal Reserve Board had expressed concern over the “unfair competitive advantage” of foreign competitors with lower capital requirements over U.S. banks, raising the possibility that Japanese banking activities in the United States would be curtailed. \textit{Board of Governors, 72 Fed. Res. Bull. No. 1 71, Orders Issued Under Bank Holding Company Act, Bank Service Corporation Act, and Federal Reserve Act—The Industrial Bank of Japan, Ltd., Tokyo, Japan} (Nov. 29, 1985) (Additional Views of Vice Chairman Martin and Governor Rice). Balanced against that risk, according to senior U.S. officials, was continued cooperation by Japan’s regulators with their U.S. counterparts. \textit{See, e.g.,} E. Gerald Corrigan, \textit{Trends in International Banking in the United States and Japan}, FRBNY Q. Rev. 5 (Autumn 1989) (The substantial presence of Japanese banks could raise public policy concerns, balanced by factors including “the very close and cooperative efforts between official institutions in the United States and Japan.”). The threat of foreign market closure gradually has become less important as Japan’s banks have downsized overseas, most dramatically in North America, although major banks continue to maintain an overseas presence. \textit{See Masahiro Kawai, Japan’s Banking System: From the Bubble and Crisis to Reconstruction 9} (Japanese Ministry of Finance, Pol’y. Res. Inst., Discussion Paper No. 03A-28, 2003).


\textsuperscript{174.} “[A] central banker whose country failed to supervise banking activity in a manner consistent with the Basle Accord would surely face a loss of influence in the international regulation of banking and find it more difficult to enter into future negotiations.” Guzman, \textit{supra} note 12, at 1880.

\textsuperscript{175.} \textit{Adrian Van Rixtel, Informality and Monetary Policy in Japan 175–178} (2002); Akihiro Kanaya & David Woo, \textit{The Japanese Banking Crisis of the 1990s: Sources and Lessons} 26–28 (Int’l Monetary Fund, Working Paper 00/7, 2000); Joe Peek & Eric S. Rosengren, \textit{Unnatural Selection: Perverse Incentives and the Misallocation of Credit in Japan}, 95 Am. Econ. Rev. 1144, 1144-45 (2005). Although the Ministry of Finance had discretionary means to enforce compliance with the Accord, \textit{see Van Rixtel, supra}, at 117–23, the introduction of “prompt corrective action” (PCA) measures in 1998 was intended to limit forbearance by requiring the authorities to take action based on objective criteria such as a deterioration in capital adequacy ratios, \textit{see Milhaupt & Miller, supra} note 157, at 68–69. PCA measures have been used almost 100 times since their introduction, and Japan’s regulators have also implemented an “early warning system” to monitor deterioration in bank management. \textit{Japan’s Banks Rebuilt}, \textit{The Banker}, Aug. 1, 2004. But the effectiveness of those measures has remained unclear in light of continued uncertainty over the calculation of Japan’s capital ratios. \textit{See Daisuke Uozumi, Controversy Builds Over Lenders’ Health}, \textit{Nikkei Weekly}, June 3, 2002.
against capital. Banks also began to take on additional market and credit risk by extending the average maturities of loans and relaxing credit standards, partly in order to improve returns on assets and increase capital.

Changes in accounting rules, and forbearance from enforcing existing regulations, also helped support Japan’s banks. In August 1992, for example, the Ministry of Finance introduced a temporary rule change that deferred the reporting of stock portfolio losses until the following fiscal year. Ministry officials were also aware of efforts by some banks to “window dress” their books by transferring bad loans to paper companies and affiliates and rotating losses from one account to another. Following the Asian financial crisis in 1997, Japan again relaxed its accounting rules—this time in early 1998 (before the end of the banks’ fiscal year in March 1998) in order to permit banks to realize unrecognized gains on property assets counted towards Tier 2 capital. Japan also permitted banks to change their accounting for securities holdings, from the “lower of cost or market” method to cost basis accounting for equities being held for investment purposes. These modifications resulted in higher capital levels, permitting many Japanese banks to increase their regulatory capital base.

From the late 1990s, Japan’s banks began to count a portion of their deferred tax assets (DTAs) towards Tier 1 capital—eventually doing so

176. See Nobuo Inaba et al., Nonperforming Loans and the Real Economy: Japan’s Experience, in Investigating the Relationship Between the Financial and Real Economy 106, 112–13 (BIS, Paper No. 22, 2005), http://www.bis.org/publ/bppdf/bispap22g.pdf; Peek & Rosengren, supra note 175, at 1–2.


178. Id. at 150.

179. Id. at 151. See also Deft Accounting Hides Finance Sector’s Ills, Nikkei Weekly, Oct. 14, 1996 (describing “accounting forbearance” practices).


183. A deferred tax asset is a tax receivable, arising from provisions against loans to a troubled borrower, which is not recognized as tax-deductible for the period. The banks’ inability to receive tax write-offs on troubled loans lowered incentives to dispose of them, which was partly offset when DTAs were allowed to be counted towards Tier 1 capital. Under Japanese regulation, Tier 1 capital can only include an amount in DTAs equal to approximately 40% (the effective corporate tax rate) of five years of estimated taxable income. See Richard
to excess, with 55 percent of Tier 1 capital on average being comprised of DTAs in 2002 and 34 percent in 2003. In theory, all DTAs can be counted against future profits and so qualify as “good” capital in Japan. The poor profitability of most Japanese banks, however, weakened expectations that the DTAs would be fully utilized, drawing into question their qualification as Tier 1 capital. Some analysts have estimated that, using a more rigorous measure, many of Japan’s banks may have had near-zero or negative capital during this period.


187. See, e.g., Japanese Banks Have Negative Capital, GLOBAL RISK REGULATOR, Jan. 2003, at 10–11; JAPAN CENTER FOR ECONOMIC RESEARCH, JAPAN FINANCIAL REPORT No. 6, CREDIBILITY OF GOVERNMENT, CORPORATE, AND BANKING SECTORS IN JAPAN 1 (Mar. 2002). Japan’s regulators have become more aggressive in assessing bank portfolios. See Anthony Rowley, Japanese Banks Take Cold Comfort from NPL Investigation, THE BANKER, Feb. 1, 1999, at 10. But regulators have delayed adopting new rules on the treatment of DTAs rather than risk slowing bank disposal of nonperforming loans. See FSA to Delay Adoption of Rules on Deferred Tax Assets, JAPAN WEEKLY MONITOR, June 21, 2004. This is partly because DTAs have cushioned the full impact of loan loss provisions on unconsolidated earnings. See Ota, supra note 183, at 583–85. Consequently, concerns remain over the accuracy of public reports on Japan’s bad loan problem and the capital adequacy of its banks. See, e.g., Mitsuhiro Fukao, Financial Sector Profitability and Double-Gearing, in STRUCTURAL IMPEDIMENTS TO GROWTH IN JAPAN 9, 12–15 (2003); VAN RIXTEL, supra note 175, at 181; BIS Urges Japan to Replenish Banks’ Capital Bases, JAPAN WEEKLY MONITOR, July 15, 2002 (quoting a BIS statement that “[m]any commentators view the official problem loan figures as understating the true scale of the difficulties”).
Certain disparities in compliance no doubt arose from preexisting differences in national practice, financial/accounting measures, and supervisory procedures, as well as the Accord’s reliance on national discretion in applying certain standards. Japan’s actions also reflected changing economic circumstances over the period, with the costs of compliance soaring between adoption of the Accord in 1988 and its effective date in March 1993.

The principal factors affecting compliance, however, arose from competition between network standards and competing domestic interests, on balance weighing in favor of adopting the Accord but against full compliance with its terms. As described earlier, senior Ministry officials agreed to support the Accord and looked to it as one means to demonstrate Japan’s commitment to global regulatory cooperation. Adoption would provide Japan with the benefits of network membership; failing to do so potentially risked network sanctions that, among other things, could damage the standing and reputation of Japan’s senior regulators.

Balanced against these interests were those of political leaders, senior bankers, and Ministry officials responsible for Japan’s budget, all of whom were actors outside the regulatory network which created the Accord, who favored a delay in fully enforcing its terms. Regulatory forbearance and changes in tax and accounting rules provided Japan’s politicians, bankers, and domestic regulators with some breathing room, postponing official recognition of the magnitude of Japan’s nonperforming loan problem as

---

188. See Scott & Iwahara, supra note 168, at 3, 55, 67–69 (discussing certain preexisting differences in Japan).

189. Although the Accord is to be applied with a “high degree of consistency,” Accord, supra note 13, at ¶ 3, “[i]n certain very limited respects (notably as regards some risk weightings) . . . the Accord allows for a degree of national discretion in the way it is applied,” id. at ¶ 6, particularly in light of national accounting and regulatory supervisory differences, id. at ¶ 14. See Maximilian J.B. Hall, Banking Regulation and Supervision 188–217 (1993) (noting the differences in implementation in the United Kingdom, the United States, and Japan); Price Waterhouse, Bank Capital Adequacy and Capital Convergence 9–12 (1991) (describing bank concerns relating to inter-state differences in the exercise of national discretion). But see John Wagster, James Kolari & Kerry Cooper, Market Reaction to National Discretion in Implementing the Basle Accord, 19 J. Fin. Res. 339 (1996) (observing that national discretion did not compromise the Accord’s goal of competitive equality in international capital).

190. Japan’s financial regulatory system in the 1990s has been characterized as a “cartel”—a cooperative group, comprised of politicians, regulators, and regulated industries, that coordinated decision-making processes in order to generate and allocate benefits among group members. Milhaupt & Miller, supra note 157, at 12–19. Partly as a result of norms among cartel members, id. at 16–21, Japan’s legislature was unable to exercise effective control over its principal bank regulator. Amyx, supra note 177, at 41–60. Instead, compliance relied substantially on informal relationships among politicians, regulators, and senior bankers. Id. at 61–84; Milhaupt & Miller, supra note 157, at 13–16.

well as the negative effect of write-downs on Japan’s declining tax revenues. The ruling Liberal Democratic Party (LDP) preferred using delay over taxpayer money and supported efforts to “evergreen” loans to important constituencies. The banks also favored forbearance, since greater balance sheet scrutiny could expose capital inadequacies, risk the possibility of national supervision, and potentially cause the resignation of senior bankers. In addition, the Ministry was able to play down the problems of Japan’s banking industry (and, by association, its own supervisory failure) and postpone legislative action that could jeopardize its autonomy.

What may be unique about Japan’s experience are the lengths to which its regulators went to remain in formal (if not substantive) compliance with the 8% minimum. Japan’s banks navigated changes in business operations and lending, risk management, and accounting policies; and Japan’s authorities refrained from enforcing their own capital regulations and adopted changes in Japanese GAAP and tax accounting that were intended to inflate capital levels. The effect has been to substantially weaken Japan’s capital requirements without Japan formally defecting from the Accord. In fact, at slight risk of exaggeration, one

---

192. Financial and tax considerations historically influenced Ministry of Finance policies, reflecting the political dominance and competing agenda of the Financial and Tax Bureaus (responsible for the Japanese national budget) over the Banking Bureau (responsible for supervising Japan’s banks). Notwithstanding the Ministry’s decision to implement the Accord, fully enforcing it would require Japan’s banks to write down a substantial amount of nonperforming loans, adversely affecting Japan’s tax revenues. Ota, supra note 183, at 558–59, 563.

193. Amyx, supra note 177, at 147–62; Gerard Baker, Spotting the End of the Bad Debt Era: Sumitomo’s Y280bn Loss May Be the Bank’s Best Birthday Present, FIN. TIMES, Jan. 30, 1995, at 19 (regarding Ministry and banking concerns). Internal Ministry of Finance tensions may have been complicated by the relationship between the Ministry’s International Finance and Banking Bureaus. The Ministry’s most senior contact with U.S. and other foreign officials was Toyoo Gyohten, the Vice Minister of Finance for International Affairs. See Peter Hartcher, The Ministry: How JAPAN’S MOST POWERFUL INSTITUTION ENDANGERS WORLD MARKETS 223 (1998). In that capacity, Gyohten was a principal contact for U.S. regulators in discussing the Accord. See SOLOMON, supra note 50, at 422–23. Nevertheless, it was the Banking Bureau that was principally responsible for regulating Japan’s banks, and it had less experience in (and perhaps less sensitivity regarding) coordinating with its foreign counterparts. Id. at 423. Consequently, while Gyohten was sensitive to the importance of network relationships, and worked privately with Gerald Corrigan, chief of the Federal Reserve Bank of New York, to implement the Accord, id. at 423–24, later compliance remained with Banking Bureau regulators who were less directly involved in maintaining cross-border relationships, see HARTCHER, supra note 193, at 223–24.

194. Regulatory forbearance, as a means to help shore up reported capital, also took place during the U.S. savings and loan crisis of the 1980s, before adoption of the Accord. See Michael S. Levitt, The Abrogation of Forbearance Agreements: FIRREA’s Ambiguities Demand a More Principled Analysis, 61 GEO. WASH. L. REV. 1314, 1314–17 (1993).
could say that the Japanese authorities pursued almost every avenue except outright defection—seeking to comply with the letter of the Accord, if not its spirit.\footnote{195. See Eichengreen, supra note 60, at 1113 ("Nothing has compelled countries such as Japan, where capital has not been written down to reflect the extent of nonperforming loans, to conform with the spirit as opposed to the letter of the Accord.").}

This is not meant to suggest the Accord’s overall impact on global capital levels has been negative. Following its introduction, declining capital levels in the world’s principal financial markets generally reversed, in many cases at substantial cost to the regulated banks.\footnote{196. Porter, supra note 73, at 76–78. See also Jackson et al., supra note 145, at 7 (indicating a rise in the G-10 industry average from 9.3 % in 1988 to 11.2 % in 1996).} Market forces, prompted by the Accord, played a substantial role,\footnote{197. Kapstein, supra note 22, at 126; Freeland, supra note 63, at 233–34.} with capital adequacy becoming a market standard for measuring a bank’s strength.\footnote{198. Porter, supra note 73, at 77–78. Threats of market closure for failing to comply with Accord standards may have also affected compliance levels. See supra note 172 and accompanying text.}

These same forces (and a rising stock market) may have caused capital levels in some jurisdictions to rise substantially above the 8% minimum,\footnote{199. See Bikker & Metzemakers, supra note 15, at 3; Jackson et al., supra note 145, at 6.} providing banks with their own business-related incentives to enhance their capital position, such as lower funding costs and a capital buffer to exploit future investment opportunities.\footnote{200. Jackson, supra note 145, at 6–7.}

Elevated capital levels alone, however, are not evidence of state compliance with the Accord.\footnote{201. A Committee paper has suggested that an actively enforced regulatory standard may permit markets to pressure banks to increase capital, although there is no direct evidence. Id. at 15.} Absent that compliance, it becomes less clear whether the weakest segments of the banking industry—where state enforcement is likely to be most needed—are in line with Accord standards. Regulatory forbearance is particularly troublesome in the case of bank capital. In general, the threat of regulatory action is necessary to induce banks to quickly meet their minimum capital requirements.\footnote{202. Joe Peek & Eric Rosengren, Bank Regulation and the Credit Crunch, 19 J. Banking & Fin. 679, 691 (1995).}
bank-related credit derivative spreads. Accord standards, however, are prudential and impose a greater cost of doing business for most banks. Consequently, regulatory leniency may provide a competitive advantage to banks organized in that state.

C. Japan's Experience, Ten Years Later

By 1998, a decade after the Accord was first announced, Asia's financial crisis had substantially weakened the Asian and world economies. Senior officials in the United States and elsewhere looked to Japan to be the engine of recovery. Yet Japan's economic conditions continued to decline during 1998, heightening global economic insecurity and prompting calls for it to introduce measures to jumpstart its economy.

Domestically, the public revelation of Japan's banking problems strained the historically close relationship between the Ministry of Finance and the LDP. Criticism of the Ministry ballooned, as did legislative interest in financial issues previously left to Ministry supervision—resulting, in part, in delays in addressing Japan's growing banking problems. Those delays came to a head in 1998 following a series of financial scandals involving the Ministry, the continued growth in bank-held bad loans, and the possibility that major banks, such as the Long-Term Credit Bank, could fail.

---


204. See supra note 168 for a discussion of the competitive advantages of a lower capital level. The Moody's Investors Service treatment of regulatory capital is instructive here. Moody's bank analyses tend to focus on economic, rather than regulatory, capital. Moody's Investors Service, Rating Methodology: Bank Credit Risk (An Analytical Framework for Banks in Developed Markets) 36–37 (Apr. 1999). Regulatory capital, nevertheless, is still relevant, since banks falling short may “see their activities restricted or . . . may even [be] closed down by the regulators.” Id. at 37. Consequently, after Japan introduced stricter prompt corrective action measures, see supra note 175 and accompanying text, Moody's announced a prospective cut in Japanese bank credit ratings—reflecting the “potential adverse effects” of those measures “‘diminish[ing] the availability of accounting forbearance to put off the recognition of unrealized losses.’” Moody's May Cut Credit Ratings of 5 Japanese Banks, KYODO NEWS SERVICE, Nov. 26, 1997. Leniency in enforcing capital requirements, rather than regulatory capital levels themselves, appears to have been more relevant to the Moody’s analysis.

205. See Amyx, supra note 177, at 273–75 (showing regulatory, political, economic, and international timelines in 1998).


207. See Amyx, supra note 177, at 166–73, 181–86.

208. See Van Rixtel, supra note 175, at 175–243 (providing a detailed account of the growing banking and economic crises during the period).
U.S. options to pressure Japan for change were limited. Direct sanctions could hurt Japan, in turn potentially damaging the U.S. and other economies. This made it more attractive to U.S. leaders to support Japanese policies that were consistent with their own, as well as to resort to symbolic and informal pressures.\textsuperscript{209} As one commentator reported, "despite the rhetoric out of Washington, the U.S. can only go so far in prying change out of Japan. . . . Washington will continue to talk tough and make legitimate demands. But it won't let Japan be pushed to the wall."\textsuperscript{210}

In this environment, global regulators and bankers began to focus more closely on Japan's banking industry and its efforts to restore banking stability. The Japanese banking crisis was not news to the world's regulators\textsuperscript{211} or the financial markets.\textsuperscript{212} What became news, however, was the admission by Finance Minister Kiichi Miyazawa and Bank of Japan Governor Masaru Hayami, in advance of an early October 1998 meeting of G-7 leaders, that Japan's banks were substantially undercapitalized.

\textit{The New York Times} later reported the meeting with Treasury Secretary Robert Rubin and Federal Reserve Chairman Alan Greenspan. Hayami advised that capital supporting Japan's major banks had dwindled to "dangerously low levels,"\textsuperscript{213} potentially resulting in Japan's banks being banned from operating internationally "if the rules were vigorously pursued."\textsuperscript{214} Even though he later claimed his remarks were limited to Tier 1 capital,\textsuperscript{215} Hayami confirmed publicly that Japan's major banks were indeed "undercapitalized."\textsuperscript{216} Deputy Treasury Secretary Larry Summers, who attended the meeting, recounted:

\begin{itemize}
  \item [209] In early 1998, for example, President Clinton had traveled to Asia, skipping a stopover in Tokyo but later "standing shoulder to shoulder with Chinese leaders criticizing Japanese economic policy," a public blow to Japan's leadership. See White House Special Briefing, President Clinton's Trip to Asia and the APEC Ministerial (FED. NEWS SERV. Nov. 12, 1998) [hereinafter APEC Briefing] (noting the comments of Undersecretary of State for Political Affairs and former Ambassador to Japan Michael Armacost). The Administration also criticized Japan's handling of its banking problems, both publicly and in private meetings with senior Japanese officials, enlisting the support of G-7, East Asian, and other leaders in doing so. Lincoln, \textit{supra} note 206; David E. Sanger, \textit{U.S. and Japanese Confer but Differ on Economic Cures}, N.Y. TIMES, Sept. 6, 1998, at A1.
  \item [210] Neff, \textit{supra} note 50.
  \item [211] See \textit{HARTCHE}, \textit{supra} note 193, at 177 (noting that then Vice Minster of Finance for International Affairs, Eisuke Sakakibara, warned the U.S. Treasury in 1996 that Japan was on the brink of a major banking crisis).
  \item [212] See \textit{supra} note 203 and accompanying text.
  \item [214] \textit{Id.} (quoting an anonymous senior Ministry official).
\end{itemize}
Governor Hayami acknowledged what I think has been widely recognized for a long time, that there are important strains on the Japanese banking system with substantial loan losses that have eroded the value of Japanese capital. But he did not say anything that broke new ground or went beyond other things that have been said for a long time, with respect to the Japanese banking system. . . . although I certainly heard a good deal that was somber and cause for concern . . . .

Reaction was swift. The following days’ G-7 meetings devoted considerable attention to Japan.218 Those meetings were bleak (one attendee claimed to have “had more fun at funerals”);219 and, while officials disagreed over various policy matters, The New York Times reported that “they agreed repeatedly and publicly that the chief villain in [the Asian financial crisis was] Japan.”220 An unusual public call by the G-7 ministers and central bank governors followed, requesting that Japanese leaders quickly use public funds to recapitalize Japan’s banks.221 The IMF and World Bank echoed that call the next day,222 with the East Asia Economic Summit following suit a few weeks later.223

Public criticism of Japan and its leadership dealt a reputational blow to the network standing and influence of Japan’s senior central bankers and regulators. Following the G-7 meeting, the Nihon Keizai Shimbun (Nikkei) newspaper (Japan’s leading business and economic newspaper) commented that the failure of Japan’s leaders to resolve the banking crisis threatened to “undercut Japan’s G-7 clout.” The article went on to report: “Japan is becoming a washout within the [G-7]. That’s what Japan’s top financial policy-makers were told at the recent Washington, D.C., meeting with their G-7 colleagues as Japanese officials got a good

---

220. Id.
talking-to at the group’s annual autumn get-together.” Reflecting G-7 concerns over the “Japan problems,” the Nikkei then warned: “In order [for Japan] to maintain a big say in [future G-7 issues], Japan should not be content with being a ‘backward pupil’ among the G-7 nations.”

Potential network sanctions favored government action to recapitalize (at least in part) Japan’s banking industry. One commentator noted, “A more hard-line stance by Washington would be useful because it would give Japanese leaders the political cover to initiate tough reforms.” Miyazawa and Hayami may have anticipated the impact of their comments, publicly announcing in Washington, D.C., shortly after meeting with Rubin and Greenspan, that public funds would be necessary to recapitalize Japan’s banks. Public statements by U.S. and other leaders improved after passage of Japan’s bank bailout legislation less than one month later.

D. A New Perspective on Japan’s Experience

Japan’s experience with the Accord may be an exception to the oft-held view that international commitments reflect, rather than influence, how states choose to act. Japan’s early experience certainly fell within that pattern—at the time the Accord was introduced, Japan’s costs of implementing the Accord were largely borne by its bureaucrats, who needed to formulate new regulations in line with Accord requirements. A rising economy lowered the costs to Japanese banks of complying with the Accord, making it easier for them to accept the new standards. Those costs skyrocketed, however, with the decline in Japan’s stock markets. Rather than defect, Japan continued to adhere to the Accord—at least nominally—by maintaining the 8% minimum, even when actual compliance

---


225. Id.


228. U.S. advisers recommended that the President praise the new legislation, “patting Japan on the back and encouraging them to get going,” even if he continued to express reservations in private. See APEC Briefing, supra note 209 (quoting Ed Lincoln, Brookings Institution). A similar message was included in the G-7 ministers’ announcement at the end of October, hailing the new laws as “a major step forward in the process of strengthening the financial system” and noting the Japanese authorities’ intention to undertake “essential swift and effective action to complete the process.” Declaration of G7 Fin. Ministers and Cent. Bank Governors at ¶ 3 (Oct. 30, 1998), http://www.imf.org/external/np/g7/103098dc.htm.

229. See, e.g., Downs, Rocke & Barsoom, supra note 75, at 387; Raustiala, supra note 1, at 397.
with the Accord was lower. Network norms and signaling may provide some new insight into what occurred.

Japan's regulators were concerned about international reaction to delaying or failing to implement the Accord. Unless Japan "played by the rules," it risked signaling a refusal to cooperate, which could potentially weaken its influence among its global network peers and lead to sanctions from U.S. and other regulators. Consequently, Japan had strong incentives to implement the Accord, help develop its provisions (such as those on "hidden assets"), endorse its terms, and formally incorporate its standards into domestic regulation.

The costs to Japan of implementing the Accord sent a credible signal to others. Simply implementing the Accord required Japan's regulators to adopt a different form of banking regulation, which was itself costly. Over time, in order for Japanese banks to maintain nominal compliance with Accord requirements, Japan's regulators and bankers incurred additional cost—for example, by adjusting domestic accounting and tax rules. Lower levels of actual compliance, however, reflected competing domestic interests, principally among actors outside the global network that formulated the Accord.

Beginning in the mid-1990s, market forces began to impose higher costs of funding on Japan's banks, partly reflecting market participants' reaction to Japan's "nominal—but fictional—compliance with the Accord." Regulators, however, continued to show considerable forbearance with Japan's lower levels of compliance, perhaps "accept[ing] that Japan [was] facing severe banking difficulties, and that regulators there need[ed] time to deal with them." Network regulators may have excused lower levels of compliance based on an understanding of the particularly costly nature of compliance in unexpected circumstances. As a result, Japan's continued adherence to the 8% minimum, even in the face of substantial economic setback, may have been "close enough"

230. See supra notes 166–174 and accompanying text.
231. See supra note 157 and accompanying text.
232. See supra notes 190–193 and accompanying text.
233. See supra note 203 and accompanying text.
234. The New Basel Accord, supra note 119, at 169 (providing the written testimony of David A. Spina, Chairman and Chief Executive Officer, State Street Corporation).
235. Embattled Japanese Banks Sweat for Basel II, 1 GLOBAL RISK REGULATOR 9, 21 (Apr. 2003). Foreign regulators were, of course, concerned about Japan's banking problems and continued to press for reform. See supra note 209 and accompanying text.
236. In that respect, Japan's deviation from the Accord may have been accepted by network members in the same way that temporary deviations from the gold standard were accepted by capital markets investors. See supra note 113 and accompanying text. Network members may have also been reluctant to claim directly that Japan had defected from a network standard, see supra notes 56–58 and accompanying text, relying instead on network pressures to pursue banking reforms, see supra note 209 and accompanying text.
to signal to other regulators its continued cooperation.\textsuperscript{237} Hayami's statements may have changed that signal by acknowledging Japan's inability to continue to adhere to the 8% minimum absent public recapitalization of its banks—a meaningful admission in light of international frustration over Japan's perceived unwillingness to move quickly to address its banking problems. The resulting threat of network sanction and "foreign pressure"\textsuperscript{238} may have helped facilitate domestic reforms.\textsuperscript{239}

E. Accord Compliance Generally

A recent IMF survey suggests Japan is not alone in failing to comply fully with the Accord. It found the implementation of global regulatory standards to be "broadly satisfactory, on average," but with important exceptions, uncovering variations in regulatory sanctions and enforcement that made the implementation of global standards uneven.\textsuperscript{240} In particular, the study noted that "capital adequacy measures are often loosely applied to promote indigenous banks, or are unreliable due to weak loan classification and provisioning practices," reflecting competing regulatory objectives and public policy considerations.\textsuperscript{241} The IMF also found, in approximately one-quarter of the assessments, deficiencies in monitoring and inspection systems meant to ensure compliance with capital and prudential requirements.\textsuperscript{242}

Another study has also found varying levels of compliance with the Accord. Its analysis of 18 states suggests that state compliance has tended to be based upon existing regulatory practices rather than Accord standards. While some convergence has occurred, the study concluded that the pre-Accord status quo was an important determinant of levels of

\begin{itemize}
\item \textsuperscript{237} See supra note 116 and accompanying text.
\item \textsuperscript{238} See supra notes 74, 158 and accompanying text.
\item \textsuperscript{239} It is possible that Japan adopted the Accord in 1988 simply in order to ease international pressure for more costly changes in domestic policy, later choosing to forego from fully enforcing its terms. See Hathaway, supra note 18, at 1941 (The "relatively costless step of treaty ratification may ... offset pressure for costly changes in policies"). That explanation, however, does not fully account for the significant costs Japan actually incurred to implement the new standards, see supra note 157 and accompanying text, and later to maintain compliance with the letter (if not spirit) of the 8% minimum, see supra notes 175–187 and accompanying text, even after the magnitude of its banking problems became publicly known, see supra notes 203, 211–212 and accompanying text. A network norms and signaling analysis fills that gap by explaining why Japan's implementation of the Accord was meaningful to others and why lower levels of actual compliance were accepted by network members.
\item \textsuperscript{240} Issues and Gaps, supra note 127, at 4. The 36-state analysis was based on assessments from 2000 to 2003 and published in late 2004.
\item \textsuperscript{241} Id. at 21.
\item \textsuperscript{242} Id. at 17.
\end{itemize}
Earlier surveys also noted variations in compliance with other Committee standards. Surprisingly, many scholars report that the Accord enjoys high levels of compliance globally. Although one can only speculate, part of the reason may be the limited number of empirical analyses of compliance to date; the IMF study was published in late 2004 and, while important, its analyses are preliminary. In addition, the Basel Committee does not monitor Accord compliance, choosing instead to rely principally on surveys and decentralized self-reporting. Committee members may also offer optimistic assessments of compliance in order to reinforce the Accord’s status as a global standard. Finally, in an industry characterized by substantial cross-country variation, the sheer number of authorities that have adopted the 8% minimum is impressive—74 percent of 106 states surveyed responded that their minimum capital level was 8% or more, and 93 percent indicated that their capital requirements were in line with Accord guidelines. Yet, as Japan’s experience and the IMF study indicate, adoption of the 8% minimum does not ensure a state is actually complying with the Accord.

The IMF study suggests that the relationship between network norms and compliance described in this Article may exist in a number of states. As Japan’s experience illustrates, network norms may modify what constitutes an “acceptable” level of compliance, permitting varia-

---


244. The Committee noted that, among 124 states surveyed, many had regulations in place consistent with the Committee’s Core Principles for Effective Banking Supervision (Sept. 1997), but had not had them fully or effectively implemented. U.S. General Accounting Office, International Finance: Actions Taken to Reform Financial Sectors in Asian Emerging Markets: Report to Congressional Requesters 24 (1999). Weak enforcement of Committee standards was also cited by U.S. authorities as one reason for the Asian financial crisis in the late 1990s. Id. at 24–30.

245. See supra note 156.


247. Barth, Caprio & Levine, supra note 243, at 10–11. The authors note, however, that ratios are not necessarily comparable from state to state due to variations in capital composition. Id. at 11.
tions in enforcing the Accord. Variable levels of compliance, therefore, may be less an indication that states intentionally deviate from standards to which they have agreed and more an indication that network norms permit those deviations to occur. Compliance that is "close enough," consistent with network norms, may be understood to signal support of the overall purpose of the Accord even when actual compliance is lower. If accurate, this explanation would help reconcile the IMF survey with statements made by Committee members and scholars regarding high levels of compliance.248

CONCLUSION

Enforcement is, for those being regulated, where the "rubber meets the road." While global standards such as the Accord evidence a growing commonality in international regulation, their practical effect will continue to vary from state to state so long as there are differences in their administration. As this Article explains, those differences may partly reflect norms which permit lower levels of state compliance to occur without being considered a defection. Future consideration of global standards and practices, accordingly, should be accompanied by a greater focus on how they are administered at the national level.

There are undoubtedly a multitude of factors beyond the scope of this Article that affect the actions of senior regulators. Over time, incorporating these factors into an analysis of state compliance should provide a more textured understanding of what causes different levels of compliance and why states choose to comply, or not comply, with international obligations. In addition, these factors suggest that future studies of global compliance should consider the extent to which norms among regulators allow for deviation from the black letter of international obligations.

Different actors may interpret compliance with, or defection from, a global standard differently. Market participants, for example, may react to a deviation differently from regulators, perhaps due to differences in context. Future research should also consider what circumstances cause such a departure and their impact on compliance, and, finally, the role that emerging global administrative regulation and practice may play in managing those differences.

248. See CHAYES & CHAYES, SOVEREIGNTY, supra note 8, at 17-18 (noting that acceptable levels of compliance may vary with the significance and cost of reliance that parties place on others' performance); Bilder, supra note 48, at 69 (finding that lowered expectations of performance may cause officials to view even occasional performance as substantive compliance).