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Fixing international finance: between international rule-making and domestic cosmetic compliance

Review By Stefano Pagliari

Department of International Politics, City University London

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International Harmonization of Financial Regulation? The politics of global diffusion of the Basel Capital Accord. By Hyoung-Kyu Chey. Routledge, London & New York, 2014. 232 pp., \$160, hardcover (ISBN-13: 978-0415812429).

The global financial crisis of 2008 to 2010 revealed a number of failures and gaps in the existing international financial regulatory architecture, and placed the issue of financial reforms at the centre of the international public policy agenda. At the same time, the crisis has also refocused the attention of academia on this topic, with a variety of scholars from different disciplines analyzing the plethora of “international standards” that have been introduced since the beginning crisis to fix these international regulatory failures.

The book by Hyoung-Kyu Chey is not one of these. On the contrary, this volume looks back at an international that been negotiated substantially long before the crisis, the Basel Agreement of 1988. This represents a milestone in the history of the international efforts to strengthen financial stability in an age of globalization by harmonizing financial regulatory policies, but it is hardly a new area of inquiry. Despite this, the contribution of this volume is likely to prove highly relevant for the literature investigating more contemporary attempts to fix the international architecture and for understanding how these attempts may fail in achieving their goals.

Compared to previous academic works on the Basel Agreement, Chey’s book shifts the analytical focus of his analysis in two ways. First, rather than focusing on understanding the design of international standards, the volume explores their implementation at the domestic level. Second, while most of the existing studies have focused on the great powers informing the development of the international financial agenda, in particular the US and more recently the EU, this book focuses primarily on those countries that are called upon implementing such rules without having significant influence over their design. In particular, the empirical contribution of this volume is represented by in-depth analysis of the adoption of the Basel Agreement within Japan, South Korea, and Taiwan throughout the 1990s and 2000s.

This analysis of these three cases demonstrates how despite the frequent description of the Basel Agreement as a “global standard” whose success exceeded the narrow membership of the Basel Committee, the adoption of the agreement in these countries frequently conceals what the author calls ‘cosmetic compliance’. These are instances in which authorities manipulate its implementation in ways that help domestic actors to formally comply but in practice still defeat its objective. The main analytical contribution of the volume can be found in the investigation of what factors have driven cosmetic compliance with international standards. The book tackles two widely established conjectures within the literature regarding the role of external pressures from powerful states and from markets in inducing convergence with international best practices. These are presented by the author as largely unable to prevent a significant amount of cosmetic compliance in the implementation of international financial standards. The analysis presented in the volume points instead towards domestic political conditions within these countries as the primary factors limiting the extent to which countries comply with international financial rules. The compatibility between international standards and the existing regulatory arrangements in different countries, the opposition from a variety of politically influential domestic business groups within and outside the financial industry, and limited independence of regulatory authorities from the political system are some of the factors presented as causing cosmetic compliance with international standards. From this perspective, the volume makes an important contribution towards unpacking the link between link between international regulatory policymaking and domestic politics. Unfortunately, the implications of these findings for the broader literature on international regulatory politics beyond finance are not explored by this study. This narrow focus is likely to limit the appeal of this volume primarily to researchers exploring the politics of financial regulation rather than to a broader readership.

Within the context of this subfield, the themes and findings presented by Chey in this volume are likely to become increasingly relevant in next few years. As the unprecedented number of international financial regulations negotiated in response to the crisis are moving from the international drawing board towards the domestic implementation phase, this book offers a key challenge for the literature: to what extent are the patterns of cosmetic compliance described in this volume characterizing also the regulatory response to the global financial crisis?

Some of the conditions identified by the author has limiting compliance continue to persist. International financial standards continue to remain instances of ‘soft law’, with no legally binding obligations for the members of the main international financial institutions to implement them at the domestic level. Moreover, as the international regulatory agenda becomes larger, its compatibility with the characteristics of different national regulatory systems among G20 members and beyond becomes more contested, thus further encouraging cosmetic compliance. At the same time,

different institutional innovations that have been introduced since the period covered in this volume, such as the expansion in the membership of the Basel Committee to incorporate emerging markets, and the institutionalization of peer-review processes under the aegis of the Financial Stability Board. Future scholarship will need to investigate the impact of these institutional innovations over the implementation of international financial standards.

A second question for the literature that emerges from the analysis in this volume is more prescriptive in nature: should we be concerned about the continuation of deviations between the standards being negotiated internationally and those being implemented domestically? The book does not take an explicit position on this question. The author clearly states that the book is not intended to be a defense of or support for “international standards”. At the same time, the book makes a convincing case that the effectiveness of international standards in achieving their objectives will be influenced by the fit between these rules and the specific characteristics of the financial system in different countries. It is therefore debatable to what extent the implementation of financial standards designed within a small club of regulatory authorities from developed countries represent the right recipe for a wider range of emerging markets and developing countries. On the contrary, a certain degree of ‘cosmetic compliance’ may be regarded at times as a welcome corrective to the ‘one-size-fits-all’ bias that characterizes the international financial standards agenda. But what is the level of cosmetic compliance that can be tolerated without generating opportunities for regulatory arbitrage that may jeopardize collective efforts to reinforce financial stability? In which areas of the financial system should cosmetic compliance be tolerated? These are key questions for the future scholarship on this topic and Hyung-kye Chey’s account of the implementation of the Basel Accord provides a helpful starting point for those scholars that will venture in this direction.