Global Administrative Law: The View from Basel

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Abstract

International law-making by sub-national actors and regulatory networks of bureaucrats has come under attack as lacking in accountability and legitimacy. Global administrative law is emerging as an approach to understanding what international organizations and national governments do, or ought to do, to respond to the perceived democracy deficit in international law-making. This article examines the Basel Committee on Banking Supervision, a club of central bankers who meet to develop international banking capital standards and to develop supervisory guidance. The Basel Committee embodies many of the attributes that critics of international law-making lament. A closer examination, however, reveals a structure of global administrative law inherent in the Basel process that could be a model for international law-making with greater accountability and legitimacy.

1 Transnational Norms and Global Administrative Law

The increasing integration that characterizes the current period of globalization has sparked a heated debate about the role that law should, or could, play in the process.¹ Some attack international ‘law-making’ by sub-national actors and ‘regulatory networks’ of bureaucrats on the ground that these processes lack accountability and legitimacy.² ‘New sovereigntists’³ argue that customary international law improperly

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displaces national arrangements of authority for law-making at the state and federal level.\(^4\) Others call for enhanced public participation and transparency in treaty-based regimes such as the WTO.\(^5\) Still others criticize the rise of international networks that operate seemingly without any form of legitimacy or accountability.\(^6\)

In response to the perceived ‘democracy deficit’ in international law-making, Benedict Kingsbury and his colleagues are attempting to build a scholarly agenda under the rubric ‘Global Administrative Law’.\(^7\) By that term, Kingsbury and his co-authors mean ‘the structures, procedures and normative standards for regulatory decision-making…that are applicable to formal intergovernmental regulatory bodies; to informal intergovernmental regulatory networks, to regulatory decisions of national governments where these are part of or constrained by an international intergovernmental regime; and to hybrid public-private or private transnational bodies’.\(^8\) The basic contention is that there is, or ought to be, a global administrative law that governs the conduct of international entities and national governments in international matters, and that in some way responds to the normative desire, shared in many ways with domestic administrative law, for accountability, fairness, protection of individual rights, and some sense of democratic decision-making.\(^9\)

This article joins the search for global administrative law, focusing specifically on the activities of the Basel Committee on Banking Supervision, an institution that meets under the auspices of the Bank for International Settlements in Basel, Switzerland. The Committee is composed of representatives of the central banks and supervisory authorities of the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States) and Luxembourg. Launched to coordinate responses to an international banking crisis in 1974 stemming from the failure of Herstatt Bank in Germany, the Committee evolved into a forum for harmonizing national supervision and capital standards for banks.\(^10\) Over the past two decades, the Basel Committee has developed progressively more sophisticated guidelines for capital adequacy in depository institutions. The Committee’s 1988 Accord (‘Basel I’) was initially intended to govern only


\(^8\) Kingsbury, supra note 7, at 5.

\(^9\) See generally ibid.

internationally active banks in the G-10 and Luxembourg. It is fair to say that Basel I is one of the most successful international regulatory initiatives ever attempted. It was adopted as domestic law by the G-10 nations, applied by them to all of their banks, and then promulgated by over 100 countries around the world although implementation varies widely from country to country. The Committee is currently engaged in a long-running process to revise the 1988 Accord, and has proposed a complex capital standard (Basel II) running at hundreds of pages.

The Basel Committee is perhaps the most important example of a transgovernmental regulatory network that exercises vast powers, seemingly without any form of democratic accountability. Imagine a club of central bankers meeting secretly in one of Switzerland’s wealthiest cities, known for its discretion, its iconic graphic design school, and boring bars. The members of the Basel Committee develop regulations governing the very lifeblood of domestic economies in ways that expand the reach of distant, unaccountable bureaucrats. Legislators may find themselves out of the loop and international banks can find no escape from burdensome rules. No wonder sober commentators such as former U.S. House Financial Services Committee ranking member John LaFalce has called the Basel process ‘fundamentally flawed’ and ‘dangerous’ and former Federal Deposit Insurance Corporation (FDIC) Chairman William Isaac described it as a ‘runaway train’. And the reach of the Basel Committee extends beyond the economies of its member countries. Developing countries face pressures from the market, the IMF and the World Bank to adopt the Basel standards even though they are not members of the club. For those reasons, some have pointed to the Basel Committee as the ‘leading suspect’ of a transgovernmental agency ‘on the loose’.

A closer examination, however, reveals a structure of global administrative law inherent in the Basel process that could be a model for international rule-making with greater accountability and legitimacy. While far from ideal, the Basel process has come a long way from the purely closed ‘club’ model of its origins, and demonstrates the possibility for enhanced accountability and legitimacy in international regulation. At the international level, the Basel committee has recently engaged in a relatively open process akin to a notice and comment rule-making in developing international capital standards, and has improved its transparency. At the domestic level, central banks and national bank regulators have enmeshed the Basel standards in the domestic notice and comment rule-making process, enhancing the legitimacy of the international process through local procedural protections. Moreover, international regulatory processes, including Basel, can in some instances help to reinforce, rather than undermine, domestic norms of accountability and legitimacy, particularly in countries where inside elites block reforms and prevent transparent domestic regulatory processes from occurring. The interaction among these international, transnational and domestic administrative procedures generates norms of behaviour and structures of practice that can help to promote accountability and legitimacy in the global administrative space.

13 See Slaughter, supra note 6.
The article explores how accountability and legitimacy can be furthered through the interplay among international, transnational and national modes of administrative law. Neither a sole focus on national administrative law nor exclusive reliance on new mechanisms within international organizations is sufficient. In some ways the Basel process is special because it involves the development of non-binding international standards that are adopted at the national level in a highly technical field. Yet we argue that a transnational process of norm transmission in administrative law can further accountability and legitimacy across a range of institutional contexts.

2 Basel and Globalization’s Critics

Why look to Basel to find global administrative law? In many respects, it is a counterintuitive choice: the Basel Committee can be held out as a prime example of ‘regulators gone amok’ if regulators’ interests diverge significantly from national governments and citizens. This section explains the aspects of the Basel Committee that could be most problematic from the vantage-point of the legitimacy and accountability of transnational regulation. The remaining sections, by contrast, suggest ways in which the Basel process has sought to overcome problems of legitimacy and accountability in ways that contribute to the emergence of global administrative law.

A Central Bankers’ Club

The Basel Committee is composed of the central bankers (and other bank regulators) of the world’s most industrialized nations. The Committee is a ‘club’ by design – small, homogeneous, and insular – designed to reach agreement quickly and act flexibly. Let’s begin with its participants: central bankers in the relevant nations (and more generally) are intended to be relatively insulated from both executive and congressional control domestically. In the United States, presidential control over the Federal Reserve Board is asserted at the time of nomination of the Chairman or members, and then is assiduously disclaimed in the interests of preserving the Board’s market credibility to conduct monetary policy. Congressional control extends to the confirmation process, and then periodic hearings on both monetary and banking policy. The strong lever of appropriations does not apply because the Reserve Board is funded through interest on its security holdings, and the Office of the Comptroller of the Currency (OCC) through examination fees paid by banks.

Other central bankers are similarly insulated, to some degree, from domestic modes of political accountability. As Willem Buiter has written, the European Central Bank is ‘typical of a central banking tradition that was, until recently, dominant across the

14 By transnational law, following Jessup, we mean ‘all law which regulates actions or events that transcend national frontiers’, including the law of nations, private international law, and national law as it relates to activities beyond the nation itself: see P.C. Jessup, Transnational Law (1956).

15 But see Strauss, ‘The Place of Agencies in Government: Separation of Powers and the Fourth Branch’, 84 Columbia L. Rev (1984) 573, at 589–591 (arguing that presidential control over independent agencies is preserved through the President’s ‘special ties’ with agency heads).
world, which views central banking as a sacred, quasi-mystical vocation, a cult whose priests perform the holy sacraments far from the prying eyes of the non-initiates. That is, this is a club of officials engaged in transnational regulation whose domestic accountability and legitimacy is subject to question from the start.

In no country is central bank independence absolute, and with good reason: nations sometimes need to act in extraordinary ways in extraordinary times, and democratic legitimacy demands that central banks operate according to the legislative parameters established for them. Their legitimacy is rooted in their legislative creation and objectives, and accountability is pursued in a formal sense through executive appointment as well as congressional oversight, and in an informal sense through professional standards, transparency and reasoned decision-making that permit outside peer review and press scrutiny, and other means. But in the advanced economies, and increasingly in the developing world, central bankers enjoy high levels of political independence. Independence tends to promote stability in monetary policy. Stability at low rates of inflation reaps benefits both in fostering internal growth and in attracting foreign capital. Yet this independence heightens concerns about the legitimacy and accountability of central bankers both in the conduct of monetary policy and in ancillary functions, including bank regulation.

In addition, because Basel operates in many respects as an informal club, the activities of the Basel Committee may be opaque and difficult to explain to the public. The informality of the Basel process serves to diminish transparency and may increase the potential for capture by special interests, particularly the largest, internationally active financial institutions. The concern that such institutions may have captured the Basel process is heightened by the fact that the final Basel II Accord provides that financial institutions can engage in a form of self-regulation by relying on internal risk measurements in determining capital standards, and the fact that such internal risk measurements themselves may prove to be rather opaque. Critics contend that this outcome is both unsound and reveals political capture.

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20 In many countries, as in the US, central banks are involved not only in monetary policy but also in banking regulation, and Basel involves both central bankers and bank regulators that are not central bankers; thus, a description of Basel as involving a club of central bankers is incomplete.
21 Self-regulation has important advantages in flexibility and responsiveness: see I. Ayres and J. Braithwaite, Responsive Regulation (1992), but may heighten concerns about accountability.
B Global Regulation

In addition to concerns of regulatory capture, the Basel process could be characterized as a kind of regulatory ‘imperialism’ in which the most powerful economic nations meet to develop rules that will affect a broad range of countries excluded from the process of developing the rules. While the Basel standards were intended only to apply to internationally active banks in the G-10, the 1988 Accord was quickly applied to all banks in the G-10, and over 100 other countries ‘voluntarily’ adopted the accord. In a sense, many of these countries had little choice. Participation in the markets that matter (the United Kingdom, the United States, Japan and the European Union) require home countries to meet Basel standards. Moreover, the International Monetary Fund (IMF) and the World Bank increasingly look to national implementation of the Basel standards and Basel-level supervision as an indication of sound national policy. In addition, members of the WTO used the lever of IMF and World Bank conditionality to foster financial services reforms, including coming up to Basel standards for capital and supervision, in countries seeking assistance. The Basel process could be viewed as an attempt by the G-10 to ensure continued hegemony over the developing world.

Moreover, even in the developed world, the move to global regulation has its critics because, in their view, harmonization blocks regulatory competition. The Basel process has been characterized by public choice scholars as an effort by national regulators to maintain ‘their autonomy in the face of international competition’. The efforts of national regulators to use global negotiations to increase their own power at the expense of domestic private actors undermines the potential for regulatory competition to lead to more efficient regulation. Competition among regulators, in this view, serves as a powerful counterpoint to bureaucratic inertia and aggrandizement. Harmonization creates lock-in that slows regulatory change and inhibits flexibility. Competition, by contrast, would require regulators to innovate to retain jurisdiction over banking organizations. If regulation becomes too burdensome, firms can shift their activities, or organizational structures, to lower-burden jurisdictions. The greater the level of coordination among supervisory authorities, the lower is the level of utility of firms using regulatory arbitrage to evade regulatory burdens. The lower threat from exit reduces incentives on regulators to develop efficient regulation.

Critics also contend that ‘home country enactment is simply a formality’. Thus, opponents of global regulation, in this view, cannot effectively challenge transnational regulation at the domestic level. International rule-making becomes a way of circumventing legislative oversight because Congress will not undo complex international agreements, and a way of bypassing real administrative rule-making because

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the domestic notice and comment rule-making will simply rubber stamp the decisions made by the regulators during their international negotiations.

3 Basel Reconsidered

A The Substantive Case for the Existence of the Basel Process

In our view, there is a strong case for international bank regulation. Prudential supervision and capital standards are generally introduced to mitigate the problem of systemic risk from bank failures and the problem of moral hazard from deposit insurance, as well as to protect taxpayers from demands for expensive bailouts in the event of widespread failures. The essential dilemmas of banking regulation can be exacerbated in the international context, both because national regulators face externalities that may hinder cooperation and information-sharing and lead to races to the bottom on capital standards or supervision, and because transnational banks can create special problems for systemic risk and regulation. Supervision of transnational banks requires coordination between home and host country supervisors.

The Basel process was designed to achieve harmonization or convergence in bank capital standards and coordination of bank supervision among the major industrialized countries whose banks dominate global banking. International banking activities and regulation generate transnational externalities that can result in credit crunches (sharply restricted supply of credit) or contagion in bank failures from one nation to another if capital standards are set too high or too low. These externalities can be mitigated in part through transnational cooperation among supervisors. Moreover, as in the debate over international bankruptcy, coordination on bank capital standards and supervision can reduce distortions in investment decisions and corporate structure.

Similarly, the Basel Committee helps to coordinate supervision to avoid strategic games by multinational firms and races to the bottom on forbearance. Large transnational failures, such as the Bank of Credit and Commerce International, have demonstrated the need for international coordination on supervision to prevent transnational firms from evading capital requirements and supervision through sham structures and transactions. Moreover, without coordination on supervision, harmonized capital standards would not prevent destabilizing actions by regulators in one country, for example, refusing to shut down troubled banks, which could affect the safety and soundness of institutions headquartered or operating in other

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26 The article makes a substantive case for having the Basel process, but does not provide a substantive defence of the Basel II Accord, which is rightly the subject of intense debate.

27 We use harmonization and convergence interchangeably. By either word, we mean the process by which national laws become more alike. In our usage, neither term requires that national laws are the same, merely that they are becoming more alike.

28 Bebchuck and Guzman, ‘An Economic Analysis of Transnational Bankruptcies’, 52 J L & Econ (1999) 775 (arguing that universality is more efficient than territoriality in bankruptcy).
Coordination of supervision limits the discretion of national regulators to forebear, providing that there is sufficient transparency and monitoring by other regulators to prevent defection. Thus, for example, the Federal Reserve Board requires compliance with Basel levels of supervision in the home country for that country’s firms to operate in the United States. Regulators coordinating in Basel can pressure their peers in other countries to provide more information, or risk exclusion from host markets.

The Basel Committee has also developed principles designed to serve as common rules of the game for bank supervisors. The Basel Concordat of 1975 set forth basic expectations among supervisors regarding how they would work together in regulating transnational institutions. In 1992, the Committee issued a set of principles on coordination between home and host regulators supervising internationally active banks. In 1997, the Committee promulgated ‘Core Principles for Effective Banking Supervision’, which were developed with cooperation from central bankers from emerging market economies and were widely adopted. The Basel Committee, together with international bodies in the insurance and securities fields, has developed suggestions for ways in which complex organizations can be regulated by regulators operating under different regulatory regimes.

Moreover, the Basel Committee generates global public goods of information and expertise. Central bankers regularly meet at Basel to exchange information and views on a wide range of topics. Because the Committee is small and homogenous, with repeated interactions among the same players over long periods of time, its members can talk with each other in an atmosphere of trust, and develop an understanding of each other that serves them well during times of international financial crises. The Bank for International Settlements, as host for the Basel Committee, also collects and disseminates information on international financial transactions and the operation of central banks. By building a consensus on the standards for reporting such information and by disseminating it, the Bank contributes to transparency.

Thus, the Basel Committee plays an important role in harmonizing capital standards, in improving and coordinating prudential supervision, and in providing global public goods of information and good offices. The case for bank capital and supervisory harmonization, however, must take account of the differences among nations.

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even among advanced economies, in the structure of financial systems and the policy trade-offs involved in regulation. It is to that issue that the next section turns.

**B National Values and Policy Trade-offs**

While harmonization of bank capital and supervisory standards serves important goals of financial stability, global harmonization in bank regulation does involve value judgments and policy trade-offs. It would be a mistake to view the Basel Committee as engaged only in value-neutral, expert, technocratic decision-making. Capital standards and prudential supervision inherently involve policy trade-offs and social norms.

Given that the work of the Basel Committee involves important judgments on contestable issues of policy, what procedures should be adopted to ensure that these trade-offs are made in a manner which ensures an appropriate degree of accountability and legitimacy? Given that the Basel process is less formal and results only in non-binding standards to be implemented at the national level, the administrative protections that are needed to achieve these objectives may be lower than in the domestic regulatory context. But informality may also diminish transparency, heighten concerns of capture, and limit the range of values considered. Informal institutions therefore might require more administrative oversight, not less. As with the debate in domestic administrative law, there are trade-offs involved in imposing formal notice and comment and similar requirements on international rule-making. If the requirements are set too high, international negotiators may seek out more informality to escape these requirements, resulting in even less public participation, transparency and review.

The informality of the Basel Committee’s work, and the fact that the result of Basel is a norm that gets further review at the national level, ought to be taken into account in deciding what administrative rules to apply, and where to apply them. In assessing global administrative law requirements, one ought to treat administrative mechanisms at the transnational and national levels as part of an integrated whole. Whenever possible, international mechanisms ought to be designed to enhance, rather than supplant, the meaningfulness of domestic administrative law. Moreover, one ought to be sensitive to developing administrative rules that will work for the wide range of administrative processes that are occurring at the international level. To begin to address these issues, in the next section we explore how the Basel Committee has fostered its own accountability and legitimacy through self-imposed administrative requirements. In later sections we examine how these efforts interact with national administrative law, and explore how international and national administrative mechanisms contribute to developing a transnational administrative law.

C Promoting Accountability and Legitimacy through International Process

The Basel Committee has become more accountable over time. The process resulting in the Capital Accords of 1988 were characterized by closed meetings with little or no transparency. Negotiations were conducted without public input, and the final rule was announced, in the words of one commentator, as a ‘fait accompli’.36 Domestic implementation in the United States and the European Union occurred without much additional process. But by the time of negotiations over the second accord, Basel had begun to open up, in part as a response to financial institution pressure for greater transparency and in part because substantive concerns with the first accord had helped to galvanize a debate over new global rules. The Committee engaged in a series of procedural steps that it had failed to take during the first accord. This section analyses the steps that the Committee has taken to increase its accountability and legitimacy, for example, through increased transparency and public participation.37

1 Notice and Comment Rule-making by the Basel Committee

Over time, banks, commentators, and regulators became increasingly dissatisfied with the 1988 Accord as overly rigid, not well-aligned with risk, subject to regulatory arbitrage, politicized, and subject to distortion. After a series of small amendments from 1998 to the mid-1990s, by 1996, the Committee undertook a much more comprehensive revision. On 3 June 1999, it issued a consultative paper, ‘A New Capital Adequacy Framework’, that laid out the ‘three pillars’ of a new accord: a more flexible, market-oriented capital standard; enhanced supervisory capacity; and enhanced disclosure so that market participants and regulators could assess bank risk. With respect to the capital standard, the Committee indicated that it would be exploring three approaches: improvements to the existing 1988 Accord, an approach based on internal risk measurement, and an approach based on models of portfolio credit risk. The Committee requested comments on the framework.

Banks, industry associations and other interested parties deluged the Committee with more than 200 comment letters on the consultative paper, expressing concerns about problems with using external credit rating agencies that are common in the US but not in Europe; concerns about the lack of differentiation among kinds of risks; and opposition to inclusion of operational risk in the capital standard.38 During 1999–2000, the Committee issued background papers to inform the public about its thinking on key issues, and held workshops with banks and other firms. Committee task forces also issued background papers on transparency to promote market discipline and on internal-risk mechanisms based on surveys of internationally active

36 See Zaring, supra note 10.
38 See Wood, supra note 22, at 134–136.
banks. The Committee received public comments on these, largely from academia and the banking industry.

The Committee released a second consultative package as a proposal for a ‘New Basel Capital Accord’ in January 2001. The proposal and supporting documents stood at a mind-numbing 541 pages. The Committee requested comments and posted replies on its webpage. The Committee received 259 comments, mostly from large industry players, but also from governments, academics, other international organizations, community banks, credit unions, and even one community group. Banks generally argued that the charge for operational risk was wrong-headed. Banks in Europe worried that increased capital charges for small business lending would disadvantage them relative to their American counterparts because the former relied more heavily on such lending. Less-developed countries worried that the Basel standards would be too complex for their supervisory agencies and banks to administer. In their view, the new approach would hasten the trend towards mergers with banks in the developed world. Meanwhile, German chancellor Gerhard Schroeder opposed the draft accord on the grounds that it would diminish German bank lending to small businesses, and the Japanese and Italian governments joined suit.

Controversy over the consultative paper and the sheer complexity of the proposal and comments on it led the Committee to postpone drafting the final version of the new accord. In June 2001, the Committee issued a press release stating that it was still reviewing the comments and that it intended to ‘continue promoting an open dialogue . . .’. The Committee noted that it was working on revisions to the proposal with respect to operational risk, small business lending and other matters. In September, the Committee issued another ‘update’ on its work, as ‘part of its continuing dialogue with the banking industry and other relevant parties . . .’. At the end of that year, the Committee announced that it would be conducting further review. The Committee noted that it ‘has been significantly encouraged by the depth and extent of interaction with market participants . . . The dialogue has been extremely constructive.’

In 2002, the Committee issued a press release stating that it had reached agreement on a number of points that had been in dispute. In a nod to the Germans, the Committee permitted a lower capital charge for lending to small businesses. The Committee yielded somewhat on capital charges for operational risk by removing the proposed floor on operational risk charges and introducing much more supervisory discretion into the assessment of operational risk. Moreover, the Committee indicated that it expected to let actual capital levels for individual banks fall below existing levels required to meet the minimum capital requirements, with gradual elimination of capital floors after the first two years of implementation.

39 Authors’ calculations based on comments downloaded from the Basel Committee’s website, available at www.bis.org/bcbs/cacomments.htm.
40 Authors’ analysis of comments on the Basel Committee’s website, ibid. See also Wood, supra note 22, at 138–139.
41 Wood, supra note 22, at 141.
The Committee received 187 comments on the third consultative package, which was publicly released in 2003. The comments were again dominated by banks and industry groups, but included comments by a range of other entities. Later that year, the Committee noted that it had ‘identified opportunities to improve the framework’ in response to the comments relating to credit losses, asset securitization, credit cards and risk mitigation; the Committee again invited comment on its specific proposal with respect to credit losses. Some 52 institutions and others commented on this proposal, and in January 2004 the Committee published proposed revisions to the consultative paper based on its review of the comments, as well as technical papers on other issues. In May, the Committee announced that it reached agreement on outstanding issues and published the contours of the consensus that had been reached.

In June 2004, the Committee finally released the new accord, entitled ‘International Convergence of Capital Measurement and Capital Standards’. The Committee ‘indicated that the Basel Committee’s work benefited from the transparency and scale of the public consultations that took place both within the G-10 countries and around the world, helping to make the new framework a global product’ and noted that the Committee ‘would continue to work in the spirit of openness and consultation in the future’. While national reviews of Basel II, discussed below, entered a heightened phase, the Committee further refined its proposals. Working with securities regulators in the International Organization of Securities Commissions (IOSCO), the Committee issued a proposal for comment in April 2005 relating to trading losses.

The notice and comment rule-making included significant participation and improvements in transparency that permitted a wider range of actors to comment on the rule-making. Moreover, by posting comments on its website, the Basel Committee made it easier for the public to assess whether the Committee was being responsive to the concerns expressed by commentators. Most participants, however, were large financial institutions. The role of the broader public was relatively muted, which reflected in part the technical nature of the Basel Committee’s work and the fact that for most public-interested organizations, the connection between banking standards and broader social concerns was not pronounced. Moreover, the costs of acquiring information and expertise in order effectively to engage in the notice and comment process at the international level are undoubtedly higher than participation in domestic rule-making, even with internet-based rule-making lowering the physical costs of participation.

Overall, the Basel Committee’s work on the new accord appears to have been responsive to suggestions made during the notice and comment process. There were real changes in the proposed standards relating to a wide variety of areas, including

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42 Authors’ calculations, available at www.bis.org/bcbs/cp3comments.htm www.bis.org/bcbs/cp3comments.htm.
how to measure operational risk, the role of rating agencies, the appropriate capital standard for small business lending, the complexity of supervisory formula, and securitizations. It is difficult to know whether the Committee’s changes were driven by internal discussion among national regulators, or by external input generated by the notice and comment process. Likely, the changes were a result of a combination of factors.

The Basel Committee also engaged in explicit cost–benefit and economic analyses supporting reasoned (albeit highly contestable) judgments, as part of the notice and comment rule-making. The Committee launched four rounds of quantitative impact studies designed to measure the impact of the proposed accord on actual levels of capital held by banks around the world. The studies were conducted using data supplied by the banks themselves, and included exercises designed to measure alternative approaches that the Committee was considering during successive rounds of consultative papers. More than 350 banks from over 40 countries participated in these studies. Results from the studies, together with analyses, were made available to the public. The last quantitative impact study found that the new accord would result in much lower overall levels of capital in the United States than previously believed, and has delayed implementation of the new accord. The Basel Committee issued a notice in March 2005 that it would be launching a fifth quantitative impact study to get a better handle on the effects of the accord and to review the data in spring 2006.

2 The Basel Committee’s Initiatives to Promote National Accountability beyond the G-10

In addition to measures designed to improve accountability and legitimacy generally, the Basel Committee made some effort to improve the Committee’s responsiveness to non-G-10 countries. The Committee recognized that the 1988 capital standards had been widely adopted, including by countries that had no role in their development. The Committee also understood that the new capital standards were likely to influence banking policy beyond the G-10, given the strong role of market pressure, and IMF and World Bank policy, on decision-making by developing countries. The Committee thus instituted a process of national and regional central banker consultations among non-G-10 nations. Over time, the Basel Committee began to invite central bankers and supervisors from non-G-10 countries to provide input into the Basel process. Central bankers formed regional groups to share information about supervision and to coordinate in providing input into the formation of global capital standards. Developing countries participated in the creation of the 25 ‘Core Principles for Effective Banking Supervision’ in 1997, which were aimed to respond to the need to strengthen domestic regulation in the developing world in the face of the series of financial crises then unfolding. Unlike the capital accords, which were aimed initially at the internationally active banks within the G-10, the explicit aim of the Core Principles was ‘to be applied by all countries in the supervision of the banks in their jurisdictions’.45 In addition to the Basel Committee membership itself, 16 other supervisory

45 BIS, supra note 31.
agencies, including some from the developing world, participated in the drafting of the principles, and the regional supervisory groups endorsed the principles.46

Developing countries also provided input into the new accord. Basel Committee members participated in meetings of the regional supervisory groups as early as 1999. The Committee formed a Core Principles Liaison Group on supervisory issues and a sub-group focused on capital adequacy composed of the Secretary General of the Basel Committee, representatives from the G-10, the World Bank, the IMF, and non-G-10 developing countries to focus on non-G-10 views and problems in the development of the new accord. Banks from a number of non-G-10 countries participated in the quantitative impact studies commissioned by the Committee. Membership in the Bank for International Settlements (but not the Basel Committee itself) also expanded over the last decade to include some emerging market countries important to global financial stability. In the Committee’s view, expressed in the third consultative paper:

[a] critical component of the Committee’s efforts to revise the Basel Accord has been its extensive dialogue with industry participants and with supervisors from outside member countries. As a result of these consultations, the Committee believes the new framework with its various options will be suitable not only within the G10 but also for banks and for countries around the world to apply to their banking systems.47

The Liaison Groups were instrumental in the development of the ‘Simplified Standardized Approach’ to capital contained as an option in the Basel II framework.

4 Promoting Accountability and Legitimacy through Transnational Processes for Incorporating Basel Norms: The Case of the United States

Basel is a non-binding standard. It needs to be implemented through national processes. National processes can, in some cases, provide an important venue for enhanced transparency and public participation by bringing the Basel process home, where the public is more likely to know how to engage, more likely to understand the implications of the Basel process for domestic issues, and more likely to find it cost-effective to intervene, either individually, or through interest groups. Moreover, national processes anchor Basel decision-making in national mechanisms of administrative accountability. These national mechanisms for administrative review provide

46 See ibid., at 3. The regional groups are: the Arab Committee on Banking Supervision, the Caribbean Banking Supervisors Group, the Association of Banking Supervisory Authorities of Latin America and the Caribbean, the Eastern and Southern Africa Banking Supervisors’ Group, the EMEAP Study Group on Banking Supervision, the Group of Banking Supervisors from Central and Eastern European Countries, the Gulf Cooperation Council Banking Supervisors’ Committee, the Offshore Group of Banking Supervisors, the Regional Supervisory Group of Central Asia and Transcaucasia, the SEANZA Forum of Banking Supervisors, the Committee of Banking Supervisors in West and Central Africa: ibid., at 3, n.3.

further input into the Basel process and thus help to shape the Basel standard in a way that is responsive to public concerns within the constituent nations of the Committee, and more broadly where the Basel standard is to be adopted by non-Committee countries. The Basel Committee ‘acknowledges the importance of national rule-making processes underway in several jurisdictions and that it will need to consider the outcome of these national processes’ before finalizing the new accord. Moreover, the Committee’s efforts to promote accountability and legitimacy through notice and comment rulemaking and public participation, have, in turn, helped to enhance these national administrative measures. As we shall show, openness at the international level can increase opportunities for public participation at the national level, improve the nature of the deliberations, and can make it more likely that domestic oversight of international rulemaking is real, not rubber-stamping. The interactions among national and international administrative processes are what make global administrative law ‘transnational.’

A Notice and Comment Rule-making by US Agencies

During the Basel process, the US banking agencies issued two advance notices of proposed rule-making regarding the negotiations. In 2000, the agencies issued an Advanced Notice of Proposed Rulemaking (ANPR) regarding whether the agencies should issue a ‘Simplified Capital Framework for Non-Complex Institutions’. In 2003, the agencies issued an ANPR on the Committee’s draft accord of that year. Significantly, the agencies sought comment not only on how the accord should be implemented in the United States, but also on the positions that the regulators should take with respect to negotiations on the accord. While comments on the first rule are not available online, the agencies increased the transparency of the process by the second ANPR and published the comments. The agencies received 125 comments, most of which were from industry; however, community group representation was significantly larger in this pool of comments than among those received at the international level by the Basel Committee. Over 25 community organizations commented on the ANPR. Most of these organizations focused on the implications of the capital rules for equity investments in community development financial institutions, small business investment companies and related investments serving the public welfare.

In addition to the ANPRs, the agencies then published additional requests for comment on agency supervisory guidance, regarding corporate credit risk and operational
risk, and the following year regarding internal risk models as a whole. The publication of a request for comment on agency guidance, in advance of a notice of proposed rule-making, served to formalize a guidance procedure that is usually subject to much less transparency and accountability than a formal rule-making. The agencies also published requests for information on the quantitative impact of the new accord as proposed to be implemented in the United States, and an interagency statement on how the agencies viewed the process of qualification for the advanced risk measurement methodologies. Thus, in this instance, the presence of transnational regulation enhanced, rather than diminished, the opportunity for public participation in domestic rule-making. Given the technical nature of the guidance and its limited applicability beyond the largest banks, however, only 18 comments were received, almost all of which were from these large firms.

In 2004, the agencies issued a press release providing notice of the Basel Committee’s issuance of the new accord. The agencies also issued a series of white papers analysing the potential effects of the new accord on home mortgage and small business lending, competition in various banking sectors, bank mergers, and other matters, including papers suggesting that the new accord could harm non-adopters with respect to the home mortgage market. The FDIC published a white paper critical of the new standards that suggested that they would result in required levels of capital much lower than currently permissible for purposes of the US Prompt Corrective Action statute, and that ‘U.S. regulators will have to choose between ignoring the output of Basel II’s formulas or significantly weakening the current PCA framework’. Recently, the United States decided to delay implementing the new accord because the fourth quantitative impact study revealed evidence regarding differential and much larger than expected effects of the new accord on capital standards among US banks. Important policy-makers continue to signal that the domestic implementation of Basel II will take longer and will be more complicated than initially anticipated.

Contrary to Zaring, the evidence suggests that this domestic rule-making process is real and not ‘too late’. Comments on domestic rule-making can and did influence the global standard and its national implementation. National administrative mechanisms can contribute to global administrative law. Moreover, the administrative measures undertaken by the Basel Committee itself, with respect to transparency, notice and comment rule-making, and public participation, appear to have enhanced domestic US administrative oversight. Industry representatives, the public, and interested parties were able to participate more effectively in domestic rule-making because they had had access to information from the ongoing Basel Committee work and were exposed to competing views taken during the international negotiations. The transparency of international rule-making made it easier for competing interests to assess whether regulatory positions taken reflected capture by important industry players.

B Differential Application by the US Rebuts Hegemony

Because the Basel Committee develops standards that are intended to harmonize national rules, rather than standards that bind nations directly, each participant in the Basel Committee can choose how to implement the new accord domestically. While national variation reduces the extent to which harmonization yields the same standard, national variation that is consistent with the essential principles of a global standard can serve to enhance the legitimacy of the global standard and increase the likelihood that the global regulatory process has a wider reach among nations.

In the United States, the agencies have chosen to develop a ‘bifurcated regulatory capital framework’ under which most banks could continue to apply a modified version of the 1988 Accords, while the largest internationally active banks (holding almost all of the US share of foreign assets and about two-thirds of all US domestic assets) would apply the advanced internal-ratings based approach developed under the new accord. Under this method, these large institutions rely on their own assessments of risk as the primary inputs into supervisory formulas for capital requirements. The largest of these large banks would be required to apply the new approach, while other large institutions could opt-in to using this methodology. The vast majority of banks in the United States would continue to apply Basel I. In the United States, this means in effect that the largest 10 banking organizations

62 Zaring, supra note 10.

63 The contrary prediction, that international negotiations undermine domestic legitimacy, derives from Robert Putnam, ‘Diplomacy and Domestic Politics: The Logic of Two-Level Games’, 42 Int’l Organization (1988) 427. Precisely because we are concerned about such possibilities, we argue for international and domestic administrative processes that are designed to enmesh international rule-making in national modes of legitimation and accountability.

64 68 Fed Reg, at 45,902. See also Testimony of Vice Chairman Roger W. Ferguson, Jr., Basel II, before the Committee on Banking, Housing and Urban Affairs, US Senate, 18 June 2003 (describing the rationale for the bifurcated approach).
would be required to adopt the approach, and the next 10 are likely to opt-in. The Basel Committee had also developed a ‘foundation’ internal-ratings based approach that required firms to use more formulaic risk inputs from supervisors, but the US agencies decided not to apply that rule to any US bank on the theory that it was too complicated for smaller banking organizations, and too prescriptive for more sophisticated ones.65

The US decision has, thus far, not undone the essential contours of agreement over implementation of Basel II in other countries. As we discuss below, many other countries have decided to move gradually or in stages to Basel II, while others are proceeding to implement Basel II for all their banks. If such national variation continues, while the consensus of moving toward harmonization under Basel II persists, then the Basel process can be seen as an important example of enhancing the legitimacy of international regulation through a fluid process of convergence, rather than a dogmatic insistence that harmonization requires that all nations’ laws be the same.

C Differential Voices among Regulatory Agencies in the United States

Other aspects of domestic implementation can also reinforce the accountability of regulators in Basel. In the United States, banking supervision is divided at the federal level among the Federal Reserve Board, the OCC, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation. The Board has been more supportive of the Basel Committee’s substantive decisions than has the other big player, the OCC. In particular, the Comptroller has criticized the overwhelming complexity of the Basel standard, as well as its continued reliance on excessive supervisory inputs.66 The FDIC has also been critical of the Basel accords from time to time.67 The Board, by contrast, has tended to support the approach taken in Basel much more wholeheartedly.

The fact that the US agencies have disagreed so strongly has itself helped to improve the transparency of the process, and may have contributed to improvements in the new standard. Officials from these agencies have repeatedly disagreed in public speeches and congressional testimony. The public disagreement provides a useful window on key disputes in the Basel negotiations, and provides the public with an


additional check on the activity of the negotiators. Moreover, the substantive dis-
agreement even with the US national regulatory regime likely contributed to more
reasoned decision-making, or at least more reasoned articulation of whatever
decision-making was occurring. The failure of the United States to speak with ‘one
voice’68 regarding Basel contributed to having a more open transnational regulatory
process. Moreover, the more transparent regulatory process of the Basel Committee
helped to reveal these inter-institutional differences, which might have been more
muted under the old ‘club’ model of international negotiations. The division among
regulators may enhance transparency, public engagement and dialogue, as well as
accountability and rationality at the international level as compared with transna-
tional regulation developed by monolithic regulators within each country. Most
nations, however, have a single, consolidated regulator for their banks, and many are
moving towards a single regulator for banking, securities and insurance. While con-
solidated regulation has many benefits, one important downside is that a single regu-
lator may result in less transparency in international negotiations.

D US Congressional Oversight

Participation of US regulators in the Basel Committee could be problematic from the
perspective of democratic legitimacy for a number of reasons. Normally, executive
branch participation in international negotiations is within the power of the Presi-
dent to conduct foreign affairs. Executive branch officials in international negotia-
tions are representing the United States. In the context of discussions in the Basel
Committee, this is somewhat problematic, because the Federal Reserve Board, as an
independent agency and in effect the lead agency in negotiations, is not representing
the President. The Federal Reserve Bank of New York, which also participates in the
Basel negotiations, is even further removed from mechanisms of presidential control
because its leadership is chosen by the system itself, and it does not represent the
United States as a nation. Nor does the FDIC. The OCC, while within the Treasury
Department and thus in effect representing the interests of the executive branch, is
also somewhat insulated by statute from executive branch control even on broad reg-
ulatory matters. There is no lead agency designed by Congress or the President.

The lack of presidential oversight of US participants at Basel heightens the need for
congressional oversight, with respect to ensuring the democratic legitimacy of the pro-
cess, holding US regulators accountable for their negotiating positions, and enhancing
opportunities for public participation and transparency in the development of transna-
tional regulation. Congressional oversight occurs both ex ante and ex post.

Ex ante, congressional authorization is important to legitimacy. With respect to the
Basel process, Congress has in fact authorized the federal banking agencies to ‘consult
with the banking supervisory authorities of other countries to reach understandings
aimed at achieving the adoption of effective and consistent supervisory policies and

975, at 1013 (arguing that the Supreme Court wrongly created doctrine).
practices with respect to international banking’. Congress also directed that the ‘Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury shall encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending’. Congress directed that US membership of the Basel club be enlarged beyond the Board and the OCC to include ‘equal representation’ for the FDIC. The banking agencies have the authority to translate international understandings into minimum capital requirements. The Senate has also confirmed the nominations of three of the four principal negotiators, which provides some additional, albeit small, measure of congressional oversight.

*Ex post*, congressional hearings provide additional transparency to the Basel process as well as a means to hold regulators accountable for the development of transnational regulation. The Congressional role *ex post* should not be overstated, however. Congressional oversight through hearings is a rather weak form of control. That is even more so when the main lever of congressional control, agency appropriations, are inapplicable, because the Federal Reserve is funded by interest on its securities holdings and the OCC is funded by bank fees. Congressional oversight also tends to be relatively weaker with respect to international matters than to solely domestic concerns.

Still, Congressional oversight does play an important role in enhancing compliance with the norms of accountability and legitimacy underlying global administrative law. Congressional committee chairs were in contact with US regulators during the course of the Basel negotiations to express their concerns about the draft accords. Both the House and the Senate held hearings leading up to, and after agreement on, the new accord. Members focused much of their concern on issues of competitive equality between US banks and foreign banks and between large US banks adopting the new internal-ratings based approach and regional and local banks continuing to use Basel I. The Comptroller used the hearings to further the OCC’s negotiating position in the Basel process, particularly with respect to the overall complexity of the proposal. The congressional hearings highlighted the central problem of governance: US negotiators at

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73 But see Zaring, supra note 10. (arguing its importance).
75 See, e.g., Letter from Cong. Michael G. Oxley, Chairman, and Cong. Barney Frank to Chairman Greenspan, 10 Oct. 2002 (expressing concern about operational risk measurements and suggesting the need for a hearing).
Basel speak for themselves, not the United States, and there is no lead agency designated by Congress or the President. Hearings have continued to highlight substantive and procedural concerns in the months following release of Basel II and notices of US implementation plans.

E Summary of US-Basel Administrative Interactions

Domestic US administrative mechanisms have helped to enhance the accountability and legitimacy of international rule-making at Basel. Similarly, congressional oversight has played a role in shaping regulator behaviour. These national measures, embedded in the democratic politics of the United States, have served as important means to fulfil the promise of global administrative law. At the same time, enhanced administrative openness at Basel reinforced domestic administrative law by making it easier for Congress to understand the trade-offs involved in the international negotiations and to police their agents’ conformity with legislative goals. Transparency at the international level also enhanced the capacity of interested parties to participate in domestic rule-making, and diminished the extent to which regulators could be captured without detection in developing the international rule subject to domestic deliberation.

US regulators at Basel are not ‘agencies on the loose’, but there is room for greater accountability and legitimacy. For example, both democratic legitimacy and national accountability could be enhanced through the congressional requirement of a United States’ negotiating position for Basel. However, requirement of a unified position might undermine transparency, because it is in part because of the dissention among US regulators that the public gained increased awareness of the Basel process and opportunities to comment meaningfully. Moving Basel more toward a treaty-making model of international negotiation and congressional approval might increase national accountability, but actually reduce public participation and transparency that have been built into the domestic and transnational regulatory processes of Basel.

5 Promoting Accountability and Legitimacy through Transnational Processes: The Case of the European Union

Other countries have developed their own procedures for participating in the Basel process. These myriad approaches can, in some cases, enhance national accountability, increase transparency and public participation, and thus reinforce the means by which the Basel process is moving towards the means and ends of global administrative law. This section looks at the European Union’s approach to the Basel process. Unlike the process for adoption of the Basel Accord in the United States and other countries, adoption in the European Union requires intermediation between Basel and national governments in the institutions of the European Community.

78 See ibid., at 31–32.
As in the United States, in the European Union the Basel Accord does not operate with direct effect; it must be made European Union law. The 1988 Accord had been issued as a Capital Adequacy Directive without much public or national debate. By contrast, during the process leading up to the new accord and since its publication, the EU has sought to enmesh the Basel Committee’s work in the EU structures of decision-making. The European Commission itself participates in the Basel Committee as an ‘observer’. The Commission implemented a ‘structured dialogue’ beginning in 2002 to facilitate communication between the Commission and the public. The Commission published a working document on the new Basel approach and solicited comments in November 2002. The working document noted that the Basel consultative paper would need to be ‘appropriately differentiated where necessary to take account of specificities of the EU context’.

In particular, the Commission focused on lending to small businesses and the desire to apply the Basel Accord to all credit institutions in the EU as important European concerns. The Commission published 115 comments received on the working document on the Commission’s website in April 2003.

The Commission released a third Capital Adequacy Directive in July 2003 as a ‘Third Consultation Paper’, based on the draft of the new accord, and provided extensive discussion of earlier comments. The EU, under the third Capital Adequacy Directive, proposed that Basel II apply to all banks, not just the largest internationally active banks, as in the United States. The Commission posted comments on the third consultative paper in the fall of 2003, and published an analysis of the 128 comments it received in March 2004. The ‘Feedback on Responses Received’ discussed the Commission’s position in detail regarding the comments. After publication of the new accord in June 2004, the Commission proposed a new Directive in July. The Directive largely follows the new accord, but with special provisions regarding small business lending, special rules for applications from cross-border financial groups to go through a ‘consolidating supervisor’ and other EU-specific approaches.

Unlike the regulatory process in the US, under which the banking agencies will publish regulations to implement Basel II, in the European Union, the Commission’s proposed Directive is to be adopted as EU legislation by the European Parliament and the European Council after deliberation and review. Whether involvement by the

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82 European Commission Proposal, supra note 80.
European Parliament is enough for national publics to view EU legislation as democratically legitimate is currently very much in doubt, but European parliamentary review may contribute to such legitimacy even if it falls short, on its own, of conferring legitimacy in the eyes of the European public.

The European Parliament had begun to review the Basel process as early as 2000, and its oversight continued over the next several years. The Parliament focused on the effects of the Basel proposals on small business and home mortgage lending, which in turn helped to inform the Commission’s work. Parliament also staked out a claim for a stronger role in the development of international negotiations on banking matters going forward. The Parliament stated that it “[r]egrets that the Basel Accord and other international agreements laying down a framework for legislation at EU level came into existence without any form of democratic mandate or control by the European Parliament; expresses the view that, in future, questions with such far-reaching political implications should not be determined in advance by expert committees alone’. The Council provided its own input into the proposed directive, resulting in changes that further adapt the Basel standards for the European Union. Most recently, the Committee of Economic and Monetary Affairs in the European Parliament submitted amendments to the proposed directive, which will likely contribute to the public debate, but further delay implementation. Still, the European Parliament approved the directive this fall.

In addition to review by the European Commission, Parliament and Council, the European Central Bank, as a ‘peer’ institution, and itself an ‘observer’ in the Basel process, published its opinion on the proposed directive in 2005. The ECB was supportive of the new directive and the underlying new accord, but urged that the regulatory details currently embodied in the directive were better left to Committee and national regulation. At the same time the ECB called for strong limits on the discretion of national regulators to provide for exemptions and waivers under the directive, and argued for greater harmonization of supervision across jurisdictions.

Member States of the European Union, at both the level of supervisory authorities participating in the Basel process directly, and at the level of heads of state, have also helped to shape the conversation regarding the Basel standards. Nine members of the European Union participate directly on the Basel Committee. As noted above, Gerhard Schroeder took a strong stance against early versions of the new accord that he believed

84 Ibid.
86 European Parliament Resolution, supra note 82, at para. 4.
87 See ECOFIN text, supra note 82, at para. 4.
89 See Zilioli, supra note 20.
would disadvantage German banks in their lending to German small businesses. Although some criticized Schroeder’s intervention as unwarranted political interference with technical banking matters, the German government’s decision publicly to stake out its position contributes to the legitimacy and transparency of the Basel process.

Once the process of enacting the directive at the level of the European Union is complete, the supervisory authorities in the 25 Member States will need to develop implementing regulations, which will again provide opportunities for public notice and comment rule-making. There is room for significant discretion at the national level under the proposed directive, and national governments will make important choices regarding implementation. These choices ought to be, and in many respects are, being opened up to public processes of participation.

For example, in the United Kingdom, the Financial Services Authority (FSA) has published three consultative papers as well as a regulatory impact assessment for comment during the Basel and Community Directive processes. The FSA received 35 comments on its 2003 consultative paper, posted them on its website, and responded to the comments in the 2005 consultation paper, in which it again solicited comments from the public. In addition, the FSA’s regulations – together with Treasury regulations under the European Communities Act – implementing the directive (once enacted by the EU) would go through review by the ‘scrutiny’ committees of the House of Lords and House of Commons as well as Parliament’s European Standing Committee. The FSA has set up working groups that include industry representatives and will continue to publish minutes of the meetings and working papers prepared for discussions with industry representatives.

There will also be opportunities for public input during the EU’s process of transnational coordination of regulation through the European Banking Committee and transnational coordination of supervision through the newly established Committee of European Banking Supervisors (CEBS). CEBS has promised to come up with measures to promote transparency, accountability and public participation in its work implementing Basel and related supervisory measures. Even before enactment of the directive, CEBS issued a consultation paper on how CEBS envisioned Basel’s second pillar, regarding supervisory review, playing out in the European Union. CEBS solicited public comment and posted the 14 responses on its website. In June


95 See http://www.cebs.org/Consultation_papers/CP03_responses.htm.
2005, CEBS began two consultation processes, one on supervisory review that tackles difficult questions regarding coordination between home and host regulators in supervising transnational financial institutions, and the other regarding credit-rating agencies in Europe. Transnational coordination of supervision within the EU thus affords additional opportunity for transparency and participation in the formation of global capital standards and supervisory coordination fostered by the Basel Committee process.

6 Promoting Accountability and Legitimacy through Transnational Processes: The Developing World

Countries outside the G-10 that are not formally part of the Basel Committee also developed domestic administrative processes regarding implementation of the new Basel capital standards. The presence of transnational negotiations helped to spur these countries to develop new administrative procedures to participate more fully in the Basel Committee’s work. As with administrative procedures in the G-10 nations, the administrative frameworks used in the developing world also tended to present additional modes to enhance the accountability and legitimacy of the Basel process.

For example, reformers at the China Banking Regulatory Commission followed the development of the Basel Committee’s work closely, and commented on the draft accords. After conducting a quantitative impact study and surveying the competitive landscape, China decided that it would apply Basel II’s second and third pillar, on supervisory review and market discipline, together with Basel I’s capital standard, as modified by the Committee. China and India decided not to apply Basel II capital standards to their banks, in reaction, in part, to the US decision to only apply Basel II to the largest US banking organizations. More importantly, both countries recognized that their regulatory structures were inadequate to the task of analysing the complex risk measurement required under the advanced internal-ratings based approach of the new accord, and that their banks were unlikely to be able to comply as well.

By adhering to the Basel I standards, and indicating that they would be moving towards compliance with the supervisory review standards of Pillar II and the market

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disclosure standards of Pillar III, China and India kept themselves in the Basel system, without having to sign on to all the elements of a new accord that would likely not work for them. Moreover, in the case of China, the decision to adhere to Basel I represented significant movement forward from a prior system characterized by regulatory laxity and little to no transparency. However, failure to adopt Basel II means that Chinese and Indian banks will need to compete (mostly domestically) with banking organizations from countries adopting the new accord, and presumably these institutions will be required to hold lower levels of capital than their Chinese or Indian counterparts. Indeed, the four major state-owned Chinese banks have already indicated that they plan to develop the infrastructure and expertise necessary to implement the internal-ratings based approach despite the Chinese regulatory agency’s position that it is not required.100

China and India found a plausible way to continue to participate in the international financial system without adopting in its entirety the new global standard. The Basel process permits national accountability and legitimacy in decision-making at an acceptable real world cost. Yet it is ironic that the closed, insular, G-10 process that gave the world Basel I resulted in widespread adoption of the first accord, while the inclusive, participatory, and transparent process of Basel II has given us capital standards that are likely inapplicable to most banks in the developing world.

Similar domestic processes have played out in other developing countries. For example, Brazil decided to move towards Basel II gradually, focusing first on proper implementation of the modified Basel I standards together with the Core Principles, then on Pillar II, followed by Pillar III, and then Pillar I. Pillar I is to be applied only to the largest domestic and foreign banks operating in Brazil.101 Chile is also moving forward with the standardized approach in the first Pillar, and only later with the advanced approaches. Chile has developed a roadmap for implementation and requested comments from industry. Earlier, Chile had requested an external evaluation of its compliance with the Basel Core Principles, and received a 76 per cent rating in 1999; an IMF/World Bank Review in 2004 found an improvement to 83 per cent, but the Chilean authorities are looking to make further reforms.102 South Africa, which has decided to move forward with Basel II for all of its banks, participated in the Basel process through the non-G10 working groups. In their view, ‘Basel II is suitable for application in both G10 and non-G10 countries, since it provides a menu of approaches suitable for both sophisticated and the least sophisticated banks.’103 The South African Bank Supervision Department promulgated a series of consultation papers and took comments, established a regular Accord Implementation Forum to

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discuss Basel II and published transcripts of the meetings, and conducted quantitative impact studies.104 Similar procedures have been utilized in a wide range of developing countries considering adoption of Basel II.

Adoption of Basel generally enhanced, or at least did not undermine, accountability and legitimacy of domestic processes, and domestic processes, in turn, tended to provide additional opportunities for public participation, transparency, and in some cases democratic input through legislatures that enhance the accountability and legitimacy of the international rulemaking process at Basel. Basel II is likely to be adopted by most countries. A recent survey on non-G-10 countries indicated that 88 of 107 countries responding intended to adopt Basel II, and that about 77 per cent of bank assets in non-G-10 countries are expected to be covered within 10 years.105 Domestic processes in the wide range of countries involved in adopting Basel II are an important element of understanding how Basel contributes to the evolution of global administrative law. Global administrative law is being developed not just at the level of international rule-making, but also in the interactions among international rule-makers and domestic administrative mechanisms.

7 Nested Regimes: The Basel Committee and the International Financial Architecture

Understanding the role of the Basel process and the appropriate nature of administrative mechanisms that ought to be deployed to enhance its legitimacy and accountability requires assessing the relationship between Basel and other international financial regimes, particularly with respect to developing nations. Basel does not operate on its own. The process of accession to the WTO financial services agreement and concomitant efforts to ensure liberalization under the agreement, resolution of currency and debt crises, IMF and World Bank policy prescriptions and lending conditions, all interact with Basel adoption in the developing world. The Basel standards, while voluntary in principle, are effectively embedded in a range of other policies and market practices that make adoption in some form or another difficult to resist for developing nations. Because these other policy and market regimes give added force to the Basel Committee’s hortatory pronouncements, the extent and nature of global administrative law mechanisms designed to enhance the legitimacy and accountability of the Basel Committee’s processes need to take account of these extra-Basel inputs.

Adherence to the Basel principles is increasingly seen as an important element of IMF and World Bank lending decisions and as an essential element of the new international financial architecture.106 IMF teams review countries for policy reforms that reflect adherence to the Basel Core Principles and have conducted more than 158 such assessments.107 For

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104 See generally www.reservebank.co.za.
105 Financial Stability Institute Survey (noted in Marshall, supra note 101).
example, a 2004 review in Chile found that its system for consolidated supervision of financial conglomerates was ‘materially non-compliant’. The IMF has conducted a series of evaluations of its country assessments. Moreover, the IMF itself views these assessments as furthering universal adoption of Basel principles. Although the IMF generally eschews requiring adoption of voluntary codes in its conditionality agreements, in practice the IMF does require the specific reform steps that in effect would bring countries into compliance with the Basel Core Principles. Moreover, countries often include adherence to the Basel principles in their letters of intent, the documents that govern country policy reforms undertaken to obtain IMF funding. A search of the IMF website revealed more than 30 letters of intent noting that the country planned to improve compliance with Basel Core Principles as a condition of IMF lending. The World Bank participates in IMF assessments, and the World Bank uses conditionality, including adherence to international bank standards, in its Financial Sector Adjustment Loans.

Adherence to the Basel Core Principles also comes into play in regards to accession to the WTO General Agreement on Trade in Services, Annex on Financial Services and Understanding on Commitments in Financial Services. Basel standards are involved in several respects. First, developing countries were encouraged to accede to the financial services understanding in order to get IMF and World Bank assistance in the wake of the financial crises of the late 1990s and banking sector reforms, including adherence to Basel principles, were essential to obtaining external funding.


113 South Korea is a prominent example (see infra), but a number of WTO accession documents explicitly discuss the Basel standards: see WTO, ‘Accession of the Kyrgyz Republic: Memorandum on the Foreign Trade Régime’, WTO Doc. WT/ACC/KGZ/3 (23 Aug. 1996), at 49; WTO, ‘Accession of Kazakhstan:
Second, the financial services accord requires market liberalization and national treatment, but permits countries to engage in valid ‘prudential measures’ that would otherwise be inconsistent with the agreement; the scope of such prudential measures is likely to be circumscribed by adherence to the Basel standards. Secondly, financial market liberalization in accordance with WTO commitments would likely be disastrous without corresponding changes in bank regulation and supervision in line with the Basel principles. In the 1990s, a good number of developing countries got into deep trouble by liberalizing financial markets when their regulatory structures were weak. Conversely, adherence to Basel principles is well correlated with financial system strength and market transparency required for financial liberalization.

These linkages across regimes generate tradeoffs. On the one hand, linking the Basel regime to IMF and World Bank lending reinforces the importance of coordination on banking supervision and capital standards and makes it more likely that countries will opt-in to the system.

While not without significant concerns about legitimacy, the Basel process can serve as a counterweight to domestic deficits in accountability and legitimacy, at least in the sectors affected by Basel. The charge of a ‘democracy deficit’ among international institutions, including the Basel Committee, rests on an assumption that domestic institutions can better protect the interests of citizens; however, in many countries this is simply not the case. If there is no domestic democracy to defer to, international institutions may enhance democratic reforms. Although one must be cautious in justifying external pressures in the name of democracy, in principle, international institutions can deploy global administrative law to protect citizens from their own governments when such governments have weak domestic administrative law and high risk of regulatory capture; promote sound policies in the face of inefficient governments; promote ‘good’ factions against ‘bad’ factions in domestic fights over policy reforms; and even promote democratic principles.

Participation in the global administrative process engendered by the Basel Committee can serve as a counterweight to weak domestic administrative law protections. Regulatory harmonization is not always imperialism, if defined in relation to the citizenry.

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Accord Ward, supra note 112.


Braithwaite, ‘Prospects for Win-Win International Rapprochement of Regulation’, in OECD, Regulatory Cooperation in an Interdependent World (1994). The OECD tax process is another useful example of such international efforts promoting domestic reforms.
rather than governments. For example, Basel played such a role in China (with respect to implementation of the Basel principles) and in South Korea (with respect to adoption of the Basel principles). China’s banks are carrying large levels of non-performing loans and prior (non-)supervision of capital ratios have masked this weakness. In 2004, China introduced a new law that incorporated elements of the Basel Core Principles for Effective Banking Supervision.\(^\text{119}\) China’s move to a new bank supervisory agency to supervise and regulate capital adequacy standards as part of the Basel process (and WTO financial services accession) will likely increase transparency in the system over time. The Basel process gave added weight to reformers within the Chinese government who wanted to see more openness in the banking sector.

In South Korea, the Basel process gave reformers added weight in internal deliberation over whether to move to a more transparent financial sector. Prior to the Asian financial crises, domestic entrenched interests opposed to financial market liberalization and transparency blocked adoption of the Basel principles. With impetus from the IMF, which effectively teamed with domestic reformers in South Korea to require adherence to improved banking supervision as a condition of lending, South Korea moved to improve its financial sector.

Thus, looking across a range of developing countries, the Basel process has in a number of contexts helped to enhance accountability and legitimacy at the national level through greater transparency and public participation. At the same time, Basel has been able to respond to the need for national accountability and legitimacy through its openness to flexible adaptation by national governments. These national administrative and legislative procedures, in turn, have helped to reinforce accountability in the Basel process. In many countries in the developing world, as in the developed economies, national and international administrative procedures appear to have been mutually reinforcing. On the other hand, making Basel participation a de facto requirement of World Bank and IMF lending and financial market liberalization under the WTO financial services accords converts Basel from a voluntary standard-setting body to an entity with real power to impose policy on countries, at least those from the developing world. Once Basel is converted from voluntary standards to policy conditionality, the case for lower levels of administrative structure weakens, and the need for greater accountability and legitimacy enhanced. Developing countries rightly could demand more transparency, and greater participation, not simply on consultative groups but in the Basel Committee itself. Reforming the IMF and the World Bank to take greater account of the concerns of developing countries—its own a worthy goal—would not obviate the need to ensure that standards developed in the Basel Committee are themselves developed in a manner that is consistent with accountability and legitimacy in the developing world. Moreover, even without explicit linkage through the IMF and World Bank, market participants look to the Basel standards in making decisions about lending to and investing in banking

organizations in the developing world. Market pressures give added impetus to the Basel standards and reinforce the ways in which the Basel Committee makes decisions that are effectively binding on a wide range of countries that are not formally part of its structure. As Basel’s norms become increasingly binding on the developing world calls for more significant measures regarding accountability and legitimacy will need to be met, by both the Basel Committee and national governments.

8 Conclusion

The city of Basel may have dull bars, but they are a lot livelier than the administrative process that has increased the transparency, accountability and legitimacy of the Basel Committee on Banking Supervision. Yet this process holds special promise for the project of Global Administrative Law. The Basel Committee has increased the transparency of its processes and broadened the circle of the Basel club. It has improved opportunities for public participation. These measures serve to increase the accountability and legitimacy of the Basel Committee’s global rule-making.

The Basel process should open up further. We would like to see greater transparency and wider participation, both by the public at large and by developing countries. But we recognize that such efforts undeniably result in trade-offs. Closed membership and informality facilitate deal-making among the countries that matter in the financial world, but also contribute to a sense in the developing world of exclusion from the international financial architecture. Substantively, Basel II standards, which involved extensive processes to increase public participation, transparency and developing country input, are paradoxically too complicated for most of the developing world to implement wholesale; however, the flexibility of national variation in the Basel process permits countries to comply with Basel I, move towards harmonization under Basel II gradually, and still not be shut out of world banking as long as countries take supervision and capital standards seriously.

Exploring the Basel process in depth helps to reveal nascent elements of global administrative law, which, this article argues, should be seen as occurring at the intersection and interaction among domestic and international administrative processes. Notice and comment rule-making in the development of global standards can help to enhance accountability and legitimacy by improving the transparency of the work of international regulators, increasing public participation, and giving added impetus to serious cost-benefit analysis and rationality review. These processes do not, and need not, occur solely at the international or domestic levels. Just as it is a mistake to look wholly to domestic law to ensure the accountability and legitimacy of transnational regulation, so too is it mistaken to look solely to new international

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120 For an example of NGO initiatives to encourage transparency and participation, see One World Trust, Power without Accountability? (2003), at 9–10 (rating BIS the lowest among inter-governmental organisations on membership control and access to information).

administrative law for such ends. Rather, it is in the legal process that occurs at the intersection of these two phenomena that the promise of global administrative law is most apparent.

The iterative processes of domestic and international administrative review are mutually reinforcing. National administrative process can improve transparency in international negotiations and root international rule-making in the norms of participating nations. Enmeshing international rule-making in national modes of administrative law can serve to improve the accountability and legitimacy of international rules, both with respect to nations and their citizens. At the same time, international administrative process can help to overcome weaknesses in domestic oversight and diminish agency costs by enhancing the opportunity for real oversight and meaningful participation at the domestic level. International administrative law cannot replace domestic measures of accountability and legitimacy; individuals would seem ill-advised to rely on vague promises of global administrative law in exchange for giving up pursuit of the protections of domestic democracy. Yet global administrative law can act to enhance domestic administrative law and help to strengthen the hand of reformers seeking to improve transparency.

As the informal ‘club’ model of the Basel Committee, the world trading order, and other international institutions gives way increasingly to more binding, more formal structures, the international community will need to find ways to respond to demands for greater accountability and legitimacy in international rule-making. There will undoubtedly be losses to efficiency, more difficulty in reaching consensus, and other costs, but carefully crafted administrative mechanisms that are sensitive to institutional and normative context can contribute to greater accountability and legitimacy, both to the nations that make up the international community and to their citizens. Such trade-offs are worth it, and may even be required, if the current move towards globalization is to avoid a backlash that makes all of us worse off.