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Normative Hierarchy in Informal Economic Institutions: Docile China versus the Assertive West

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Abstract

The rise of non-Western powers, particularly China, is often viewed as undermining international economic governance. This crisis is generally thought to be more severe in informal institutions such as the G20 and the Basel Committee because of their extensive reliance on normative consensus. However, developments after the global financial crisis reveal a different picture. Throughout the process of macroeconomic policy cooperation, G20 deliberations were significantly affected by Germany's negative attitude. With regard to banking regulations, the US repeatedly delayed the implementation of rules agreed upon by the member states. In both cases, however, Chinese compliance and cooperation were relatively good. To explain this unexpected occurrence, this article offers an analytical framework of normative hierarchy drawn from realist institutionalism and realist constructivism studies. Using this framework, the article illustrates that informal institutions are endowed with a hierarchy in which superordinate Western states supply subordinate states like China with norms and ideas on how to behave and choose policies.

Keywords: *Basel Accord, Bretton Woods, financial regulation, institutions, normative hierarchy*

1. Introduction

Since the end of the Bretton Woods system, the role of informal institutions in international economic and financial governance has drawn the attention of international relations scholars and political economists (Farrell and Héritier, 2003; Vabulas and Snidal, 2013). In this context, the term *informal institutions* refers to institutions lacking precise rules that are endowed with law-enforcement powers and rely to a large extent on norms and customs. G groups such as G7/G20, which shape international macroeconomic governance, and the Basel Committee on Banking Supervision are two

examples of informal institutions. These institutions have achieved moderate success in dealing with the dynamism of the international macroeconomy and finance by virtue of flexibility, which is the major advantage of informal institutions.

Meanwhile, the rise of emerging states – China in particular – has become a considerable concern for advanced states, especially after the global financial crisis of 2008-2009. Because the effectiveness of informal institutions has been supported by shared norms among a small number of advanced states, the emergence of "state capitalist" states like China, which do not share liberal economic norms with advanced states, was expected to have negative effects on the *status quo* (Bremmer, 2010; Halper, 2010).

However, what has come to pass has differed significantly from that expectation. As we will describe below in detail, although China has been feared as one of the most serious threats to the liberal international order among emerging states, it has consistently exhibited a cooperative attitude since joining the informal institutions. Major advanced states such as the US and Germany, on the other hand, have committed rather deviant behaviours with regard to internationally pursued policy goals.

How can we understand such an unexpected situation? To begin, this article offers an analytical framework focusing on the normative hierarchy involved in informal institutions and then applies it to explain cases of international banking regulations and macroeconomic cooperation. The purpose of the analytical framework is not to create a theory applicable to all behaviours of China in global governance across issue areas. Rather, its purpose is to explain the apparently counterintuitive cases where China exhibited more cooperative behaviours than major Western countries in global governance. In this sense, our approach here is close to a "theoretically guided historical account" (Gourevitch, 1986: 34). Based on this analysis, we draw the understanding that the different degrees of international cooperation between major Western states and China can be recognised as a reflection of normative hierarchy in informal institutions derived from disparity in the power resources held by both sides. Thus, this paper challenges the pervasive view that the rise of China would inevitably undermine cooperation in international economic governance by bringing a different sort of capitalism.

2. Norm Supplier and Norm Demander

Much of the mainstream constructivist literature seems to have some "liberal bias", in which the diffusion of norms in international society is thought to contribute to the establishment and maintenance of a liberal international order in which international public goods are promoted under relatively equal interstate relations (Adamson, 2005; Epstein, 2012). In contrast, recent realist

constructivism literature tends to focus on the relationship between norm and power or hierarchy. Best (2010), for example, argues that the International Monetary Fund began to adopt a 'constructivist strategy' by recommending a policy package that included fiscal transparency, banking supervision, and corporate governance as best practice. It encouraged developing states to voluntarily adopt it. In this context, norms and policy ideas are used as power resources to steer emerging states towards adopting a particular type of economic policy. From the standpoint of an emerging state, pressure for adopting that particular type of policy is quite strong, as the perception deeming that policy sound is diffused through the norms and ideas among financial market participants. The concept of productive power, which asserts that the wide spread of particular knowledge or a perception can lead to the construction of social abilities of actors, is also relevant here. In turn, these can be transformed into power relations among the participants (Barnett and Duvall, 2005; Chwieroth, 2013). For example, categories such as 'democratic state' or 'liberal market economy' prescribe the positions and abilities of states in the international society.

This line of inquiry highlights that the diffusion of norms separates related actors into two categories: the first is the actor who diffuses norms and policy ideas, and the second is the actor who receives and accepts them. In this article, we call the former the 'norm supplier' and the latter the 'norm demander'. The norm supplier is a state that diffuses norms and policy ideas about international governance issues to other states. The norm demander is a state that accepts norms and policy ideas presented by other states. The relationship between the two kinds of actors tends to be hierarchical in the sense that a norm supplier teaches and guides a norm demander about how to behave and choose policies with regard to international governance issues.

To be a norm supplier, it is a prerequisite for a state to establish its own norms or policy ideas so that they can be applied to a particular international governance issue. The establishment of such norms and ideas usually requires a high standard of economics and other social science research, as well as a rich accumulation of policy experience. In addition to the establishment of a state's own norms and ideas, the endowment of institutional resources that can be utilised to diffuse the norms and ideas is also important (Bell, 2012). Institutional resources for a state in this regard generally refer to international institutions that tend to support that state's position. A typical example is the IMF or the World Bank for the US, as the term "Washington Consensus" implies. As will be discussed later, the European Central Bank (ECB) can also be viewed as an institutional resource for Germany. National regulatory institutions with renowned status in global financial markets, such as the US Federal Reserve, can play a similar role. These institutional resources are useful for a norm supplier because they supply various means to diffuse norms

and ideas, such as the remarks and papers of economists or officials. Such resources generally convey a sense of technicality and political neutrality to norms and ideas.

Conversely, a norm demander does not establish its own norms and ideas that can be applied to international governance issues due to an underdevelopment of economic and other related policy knowledge. Accordingly, it tries to acquire legitimacy and technical knowledge about its own behaviours and policy choices by accepting norms and policy ideas presented by a norm supplier or international institution that is heavily influenced by it. Even if a norm demander creates some of its own ideas, they would tend to be interpreted as mere reflections of self-interest and be unlikely to be persuasive due to the lack of institutional resources to support them.

Next, let us consider the problem of how the hierarchical interstate relationship discussed above can be compatible with the stability of informal international institutions. According to Stone (2011), it is inevitable that a state that holds the structural power deviates from the rules in informal governance when these are associated with its vital interests. Structural power in this context refers to the possession of alternative means, such as regionalism, unilateralism, and the coalition of the willing, other than a particular international institution, to pursue policy goals. Yet, for states that lack such alternative means, it is beneficial to keep the powerful state within the institution, thus ensuring the chance to express their voices to it while tolerating its occasional deviant behaviours.

By summarising the above analysis, we can introduce an analytical framework on normative hierarchy in informal international institutions. First, the formation and maintenance of informal international institutions, which rely upon normative consensus, are often accompanied by the process of separating related states into two kinds of actors in accordance with their level of economic and other policy knowledge: norm supplier and norm demander. The relationship between them is hierarchical in that a norm demander in need of legitimacy and technical knowledge about its policy choices is basically cooperative with international institutions, whereas a norm supplier occasionally deviates from the rules formulated by them.

3. International Banking Regulations

The institutional feature of the Basel Committee, the primary institution for international banking regulations, is indisputably informal due to its history, organisation, and regulatory standards (Goodhart, 2011: ch. 14-15). In fact, the origin of the Basel Committee, the G10 finance group itself, was a customary meeting held along with regular meetings of the Bank of International Settlements. Moreover, as the committee itself emphasises

(Basel Committee on Banking Supervision, 2013), its formulated 'regulations' are not legally binding, and effectiveness relies solely on their implementation by member states.

Despite such informality, the Basel Accord, mainly known for defining the capital requirements for international banks, has been introduced in more than 100 countries other than committee members and is widely recognised as the global standard of banking regulations. One of the prime factors explaining such voluntary compliance is that many national regulators regard it as technically useful for enhancing the loss-absorption capacity of banks and restraining their risk-taking.

Besides, two kinds of normative factors play crucial roles in promoting compliance. First, the necessity of preventing global systemic risk, the fundamental purpose of the Basel regulations, is widely recognised. In a case where the capital base of international banks in their home countries is undermined, the soundness of their overseas subsidiaries and branches would usually be damaged. Furthermore, due to an increase in the interconnectedness between national financial systems, the international contagion of bank runs has become more devastating in recent decades. In these circumstances, it is highly probable that a failure in banking supervision in one country carries negative externalities internationally. Therefore, many states accept the necessity of adopting global regulatory standards formulated on the basis of advanced regulatory and supervisory experiences.

Second, the norm that a level playing field for international competition should be ensured is also accepted by many states. It is generally easier and less costly for commercial banks to raise money through deposits than through capital markets, since a substantial part of deposits is covered by official deposit insurance, and the habit of depositing is still pervasive among the public, whereas the cost of shareholders' equity is vulnerable to market fluctuations. As a consequence, if capital requirements are introduced only in a small number of states, the international competitiveness of banks from these states would be significantly lowered. So it is necessary to simultaneously introduce the same level of regulations, at least for major international banks' home countries.

In addition, market discipline works to some degree to encourage states to adopt capital requirements in a situation where they are intersubjectively shared as an indicator of the soundness of banks by financial market participants. Although, as mentioned above, the Basel regulations are recognised as the global regulatory standard, it is unclear whether they are truly effective in ensuring the soundness of banks, whereby the increase in capital level required by them certainly puts additional costs on banks by restraining bank lending and thereby putting downward pressure on national economic growth.[1] The poor performance of the Basel regulations, evidenced

by their failure to prevent the East Asian and Japanese financial crisis in the 1990s and the recent global financial crisis, also puts their effectiveness into question. Nevertheless, once the perception that banks not satisfying the Basel requirements are unsound spreads among participants of stock and interbank markets, and the situation of the spread of the perception is recognised, those banks will probably be unable to raise money. Thus, shared perception influences the behaviour of market actors in a self-fulfilling way, so that states are pressed to comply with the requirements despite uncertainty concerning their effectiveness (MacKenzie, 2008).

In 2009 the membership of the Basel Committee expanded from 13, the majority of which were G10 members, to 27, covering all members of G20. How did this expansion of membership change the effectiveness of international regulations? One concern was that the participation of emerging states – particularly ones like China, which pursues state capitalism in which the financial system is mostly dominated by state-owned banks – would undermine the normative consensus among member states, which was established in the period when the committee was a club-like forum of liberal advanced states.

However, the real situation differs significantly. The Basel Accord has undergone major revisions twice since the introduction of its original version, Basel I, in 1988. In Basel II, which was agreed to in 2004, the risk management models of large US banks were explicitly introduced into regulatory measures on the initiative of the Federal Reserve. However, while the EU and Japan started to implement Basel II in accordance with the schedule agreed to by the committee, the US unilaterally determined one year's delay of the implementation after demonstrating some confusion (e.g. announcing the Basel IA modification) and in the end failed to fully implement it due to the outbreak of the global financial crisis (Tarullo, 2008).

A similar tendency has been observed regarding Basel III. Basel III, which requires banks to meet a higher core capital ratio than the previous versions, was formulated mainly on the initiative of the US and Great Britain. Nevertheless, the US again unilaterally announced the delay of the implementation of Basel III in November 2011 and began to implement it one year later than the internationally agreed-upon schedule. The delay of implementation increased the probability of international systemic risk and might have reduced the overall compliance level by giving other states the incentive to follow suit or take countermeasures. Indeed, in response to the US's delay, the European Banking Federation requested Michel Barnier, EU commissioner for financial regulation, to postpone the enforcement of CRD IV and CRR I (the European version of Basel III) by one year (*Euroweek*, 30 November 2012). At the European Banking Congress in Frankfurt, Sabine Lautenschläger, vice president of the German Bundesbank, suggested

tougher supervision over US financial institutions operating in the Eurozone in case they would not participate in Basel III (*BBC Monitoring European*, 25 November 2012). Given the US's failure to implement Basel II, European states are still doubtful about the sincerity of the US with regard to Basel III. It remains possible that US unilateral behaviour will trigger the deterioration of European incentives of compliance (*Wall Street Journal*, 11 September 2010: A1; Lavelle, 2013: 239).

Compared to the US, China has demonstrated high loyalty to the Basel regulations. China began to introduce the Basel regulations into its domestic regulations long before its participation in the committee. Since its participation in the Basel Committee in 2009, the China Banking Regulatory Commission (CBRC) and the People's Bank of China have promoted the rapid introduction of Basel II and III. Under an original plan announced in May 2011, CBRC set a higher core capital ratio than Basel III and planned to start the implementation process and finish its full implementation earlier than the internationally agreed-upon schedule (CBRC, 2011). Even when faced with the announcement of the US's delay in November 2012, the vice chairman of CBRC, Wang Zhaoxing, emphasised CBRC's loyalty to the Basel regulations by stating: "The US decision will never have an impact on China's policy to implement the rules as originally planned. China will continue to participate in the reform of the international financial system as a member of the international financial society" (*Shanghai Zhengquan Bao*, 21 November 2012). However, the US's delay might make Chinese banks less competitive internationally.

3.1. Difference between China and the US

How can we understand these contrastive behaviours of China and the US? A background factor of China's positive attitude towards the Basel regulations is the legacy of planned economy, namely the unclear demarcation between public finance and commercial bank lending. Chinese commercial banks have historically been forced to finance investment projects that lack profitability by local governments and state-owned firms that have pursued rapid growth even under tight fiscal constraints (Shih, 2008). As a result, the Chinese economy tends to suffer from serious problems of bad credit and inefficiency of the overall national economy. In order to improve such a situation and enable banks to acquire the capacity of intermediating money from savers to corporate investments on a commercial basis, it is vital to establish a risk-management and corporate-governance system. The Basel regulations are regarded as an essential measure for this reform.

On the other hand, the Basel regulations are also associated with certain drawbacks, which are well recognised among political economic actors

in China. For example, an ex-vice chairman of CBRC, Tang Shuangning, requested his successors to introduce Basel III more slowly and cautiously when they planned to finish implementation before the internationally agreed-upon deadline (*Diyicaijing Ribao*, 23 March 2012). The steep fall of share prices of commercial banks in response to CBRC's announcement to introduce Basel III implied that market participants expected the introduction to constrain the profitability of commercial banks. *Huanqiu* magazine carried an article that even argued, with reference to a widespread suspicion that the objective of the previous Basel regulations was to weaken Japanese banks, that Basel III was a Western conspiracy to slow down the growth of Chinese banks (*Huanqiu Caijing*, 21 February 2012). Ba Shusong, vice director-general of the Research Institute of Finance of the Development Research Centre of the State Council, criticised Basel III by stating, 'the West got sick and the East took the medicine', meaning that several new rules, such as counter-cyclical buffers that were mainly designed to tackle the problems of Western banks, would probably generate harmful effects on developing economies whose reliance on bank lending was much greater (Ba, 2012).

When the US postponement of Basel III was announced, Zhu Guangyao, vice minister of finance, indicated that China should also be cautious about the consequence of the new regulation, because lending to small and medium businesses could be restrained in China, as was pointed out in the US. The consequence of the reduction of bank lending on economic growth may be especially severe for states like China, where a large portion of financial intermediation is undertaken by commercial banks. Xiang Songzuo, chief economist of the Agricultural Bank of China, also maintained that it was not necessary for China to rapidly introduce Basel III, given that previous versions of the Basel Accord failed to prevent the major financial crises and banks' excessive risk-taking (cited in *Yingcai*, 6 February 2013).

Based on these observations, it is unlikely that China simply believed it would acquire the ability to prevent systemic crises and improve bank management just by adopting the Basel regulations. Hence, in order to explain China's extremely positive attitude, we should take legitimacy concerns into consideration. First, the high legitimacy of the Basel regulations was helpful for domestic reform of the financial system. Capital requirements that encourage more prudent lending could conflict with the interests of state-owned firms and local governments in need of lending. Needless to say, the burden of additional capital requirements for banks themselves is also heavy. In such a situation, the legitimacy that international agreements entail can be used as external pressure by the financial authority to overcome the potential resistance against the regulatory enforcement. Second, compliant behaviours of banks to the Basel regulations are generally perceived as legitimate in global financial markets and hence make external market access easier.

Therefore, the intersubjective perceptions of Basel capital adequacy standards as a benchmark of sound banking among financial market participants press states to voluntarily adopt them. It is significant in being acknowledged as having a sound banking system, especially for states like China, which are beginning to pursue foreign operations expansion.

The positive attitude of the financial authority towards international regulations was shared by those that would also be regulated by it: the commercial banks. For instance, when the Bank of China was selected as a global systemically important bank (G-SIB) on which additional capital requirement would be set by the Financial Stability Board (FSB), a manager of the bank was reported to have expressed his feelings as 'half pleasure, half anxiety' (cited in *21 Shiji Jingji Baodao*, 8 November 2011: 9). A financial analyst in another Chinese bank congratulated the selection, interpreting it as proof that a Chinese bank had entered the world-premier league of finance. This positive attitude of Chinese banks towards regulatory enforcement was highly contrastive with that of US banks (*Financial Times*, 12 September 2012: 1). As such, it is evident that China demands the policy ideas embodied in the Basel regulations in order to proceed with domestic financial reform and acquire better acknowledgement in global financial markets.

The US's behaviours differed significantly from those of China. Its poor performance in the implementation phase, despite its leading role in the rule-making process, seems hardly understandable. The case of Basel II was particularly notable, as the revision of the original Basel I was actively promoted by the US Federal Reserve, which at the time was facing intensive demands from US-based bankers' associations, such as the Institute of International Finance and the American Bankers Association.[2] The direct factor behind this paradoxical situation was supposed to be the fragmentation of the US domestic regulatory system, in which three federal regulatory agencies – the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) – coexist and independently supervise domestic banks with different policy purposes. This regulatory fragmentation reflects the fragmentation of the financial system itself, which consists of thousands of small local banks. It tends to be extremely difficult to reach a compromise about appropriate and fair levels of regulations in a situation in which each regulator promotes each priority that reflects its clients' considerations (Garten, 2001).

In addition, a more fundamental reason why the US can give priority to domestic policy adjustments is that it is a supplier of the policy idea that constitutes the basis of the Basel regulations. Indeed, the core framework of the Basel regulations drew largely upon US regulatory and supervisory experiences. For example, US regulators experimented with risk-weighting approaches as early as the 1950s (Quillin, 2008: 180). Thus, as a consequence

of being in a position to provide technical knowledge for international institutions, the necessity of sticking to the Basel regulations in order to help US banks acquire acknowledgement in global financial markets is relatively low. To put it differently, as far as the US is concerned, the adoption of the Basel regulations is not indispensable for the improvement of its regulatory and supervisory capability, since US domestic institutions such as the Federal Reserve were originally endowed with regulatory measures of the Basel regulations. Rather, most advanced measures and know-how in the field of financial regulations are derived from US experience of regulating and supervising the world's largest financial market, and this situation was well recognised in global financial markets in which US-based financial institutions and investors are the most influential players. In short, the US has alternative means (i.e. regulation and supervision by domestic institutions) to make market participants confident in the soundness of US banks. Hence, faithful implementation of the Basel regulations is not necessary to create this perception.

Conversely, China, as a norm demander, needed the legitimacy and technical knowledge involved in international regulations settled by authoritative institutions such as the Basel Committee and the US Federal Reserve. Therefore, it had few options but to follow the Basel regulations in order to acquire credibility and legitimacy among financial market participants, even in a situation in which the competitiveness of its commercial banks could be disadvantaged by a more radical tightening of regulations than the international agreement or by the deviance from proper implementation by a norm supplier state.

4. International Macroeconomic Cooperation

Since the end of the Bretton Woods era, G groups have become the main forums for macroeconomic cooperation of finance ministers and central bank governors, or the heads of major states. Among them, the G20, of which membership includes both advanced and emerging states, was established at the finance minister and central bank governor level after the Asian financial crisis. It began to attract significant attention from major states after the summit-level conference was first held in Washington, D.C., in 2008 in response to the deepening global financial crisis. Then the G20 designated itself as the premier forum for international economic cooperation in the statement of the G20 Pittsburgh Summit held in September 2009 (G20, 2009).

The key institutional characteristic of G groups is informality, in the sense that they lack formal rules of membership, the formal authority to make rules, and the formal processes for decision-making (Baker, 2006; Woods, 2010). This informality has been consciously pursued and maintained in order to

facilitate free and relaxed discussion and confidence-building by leaders, ministers, and governors of member states. To compensate for the lack of formality, the consensus of norms and policy ideas play important roles.

With respect to macroeconomic policy cooperation dealing with the global financial crisis, the most crucial normative factor that supports effective cooperation is the revival of Keynesianism. Although economic thinking and policymaking had been dominated by neoliberalism in previous decades, the global financial crisis generated renewed interest in the insight of John Maynard Keynes and Hyman Minsky about the essential instability of financial markets and made the ideas of so-called new Keynesians, such as Paul Krugman, Joseph Stiglitz, and the then IMF chief economist Oliver Blanchard, more influential (Skidelsky, 2010).

Furthermore, international cooperation with Keynesian stimulus policies that were originally designed as remedies for domestic recession was supported by the norm that the nightmare of the interwar period must be avoided. Based on the historical experience of the 1930s, such as the spread of beggar-thy-neighbour policy and block economies, it was probable that the international economy would face a zero-sum game in severe recession phases like the period after the recent financial crisis. This means that if a state unilaterally creates demand by spending fiscal expenditures, other states might free-ride on the demand by increasing exports to that state. To overcome such a problem through collective action, it is essential to ensure international policy cooperation (Stiglitz, 2010: ch. 8).

In such a normative atmosphere, the IMF managing director Dominique Strauss-Kahn, who described the world economic situation as a "Keynesian recession", proposed a global fiscal programme amounted to be 2% of the world GDP in November 2008. In addition, the UK government announced a fiscal measures package of 20 billion pounds (Farrell and Quiggin, 2012: 20-23). Lawrence Summers, senior economic advisor to US president Barack Obama, said in an interview that the macroeconomic focus of the G20 should be on global demand (*Financial Times*, 9 March 2009: 1). Thus, the IMF and Anglo-American policymakers who had been chief advocates of neoliberalism unanimously turned to Keynesianism after the global financial crisis.

The G20 London Summit in April 2009 arguably marked the peak of international macroeconomic cooperation. The most significant achievement of the conference was that the concerted application of expansionary policies was confirmed in the leaders' statement. Actual numerical targets to be achieved by the end of the next year, such as the amount of fiscal expansion and output growth, were also written down in the statement. This agreement was largely in accordance with a request from the US, which regarded its huge current account deficit as evidence of other states' free-riding on American demand.

In this situation, Germany concentrated its efforts on not bearing an additional obligation of fiscal expansion exceeding its predetermined amount, although it announced a series of stimulus packages, partly because it was required to do so in the EU. Chancellor Angela Merkel openly rejected the extra stimulus packages advocated by British premier Gordon Brown at the stage of preparing a common position of EU member states at the Summit (*The Guardian*, 20 March 2009: 1). German finance minister Peer Steinbrück was also reported to have described the failure of US efforts to reach agreement for an additional round of fiscal stimulus in the summit as "very beneficial" (*EIU ViewsWire*, 2 April 2009) from the beginning of the process of international policy cooperation. Above all, China announced a four trillion yuan (approximately 586 billion dollars) stimulus package, an amount equal to 12.5% of China's then GDP, about a week before the G20 Washington Summit. One day before the G20 finance ministers and central bank governors' meeting in London, Chinese premier Wen Jiabao declared that China could undertake additional measures for boosting economic growth at any time (*Xinhua Wang*, 14 March 2009).

The difference in the attitudes of Germany and China became increasingly more pronounced. At the G20 Pittsburgh Summit in September 2009, the United States pursued a strategy to shift the responsibility of playing the role of the "locomotive" of world economic growth to surplus states, particularly China and Germany. The IMF's Blanchard endorsed this US position by indicating the necessity of a shift in the pattern of global demand away from the US (*Financial Times*, 21 September 2009: 9). Gordon Brown also advanced a plan for a "global compact" for coordinated stimulus policies by major economies (*Wall Street Journal*, 22 September 2009: 2). Contrary to US and UK positions, Germany insisted that a coordinated exit strategy from expansionary stimulus packages should be launched as soon as possible, because excessive expansionary policies would lead to inflation.

Despite facing similar pressure as Germany as a surplus state to share the responsibility for stimulating the economy, China did not follow the German path. Instead, it largely stayed loyal to the norm of Keynesian policy cooperation. At the Pittsburgh Summit, Chinese President Hu Jintao emphasised the importance of economic growth and insisted on the continuation of concerted stimulus policies and active utilisation of the G20 meetings. He also alluded to an intention to accept the adjustment of the export-led growth model in his remarks on the necessity for more balanced world economic development in terms of saving–investment balance and international trade.[3] This Chinese stance cannot be seen only in terms of China's concerns for its domestic economy, given that anxieties over inflow of hot money and the investment bubble were rising, and the necessity of an exit strategy already began to be discussed among Chinese policymakers.

Following the contradiction between the US and Germany, the summit's statement revealed ambivalence about an exit strategy and the responsibility of policy adjustments for redressing global imbalances.

In the G20 Toronto Summit of June 2010, it became obvious that major states had begun to prioritise their domestic or regional concerns. The persuasiveness of the German argument that austerity should be prioritised over economic growth was enhanced by the evolution of the euro debt crisis. The US pursued concerted expansionary policies, as always, and warned Germany about the risk of a premature adoption of exit strategy. In response, Germany's finance minister Wolfgang Schäuble claimed that excessive fiscal deficit and high inflation could bring more severe consequences than the decline of economic growth (Farrell and Quiggin, 2012: 41). Regardless of the US stance, European states were pressed to adopt Germany's push for austerity measures in a situation where the spread between German and other Eurozone governments' bonds came to be recognised as their sovereign risks in global financial markets. In Britain as well, in contrast to his predecessor Brown who sought to take the international initiative of crisis management, David Cameron, whose Conservative-led coalition took over in 2010, emphasised the risk of becoming another Greece and turned to fiscal consolidation.

Given these unfavourable circumstances, the US was forced to choose a compromise and tolerate the declaration of the summit emphasising the importance of austerity rather than economic growth. For example, the declaration clearly states the commitment by advanced states to halve deficits by 2013 and reduce government debt/GDP ratios by 2016, although it also mentions the continuation of fiscal stimulus. This shows that the Toronto Summit was the turning point that put an end to the phase of Keynesian policy cooperation (Farrell and Quiggin, 2012: 40-43; Blyth, 2013a: 59-62).

While the disagreement in the West became obvious, China consistently remained loyal to the norm of US-led Keynesian cooperation. At the G20 finance ministers' meeting in Busan, which was held in the same month as the Toronto Summit, Chinese finance minister Xie Xuren argued for the continuation of active fiscal policies and moderate monetary easing, and he declared the promotion of expanding domestic demand and the transformation of the economic growth model that had contributed to the accumulation of the current account surplus (*Xinhua Wang*, 5 June 2010). Additionally, just prior to the Toronto Summit, China announced the decision to increase the flexibility of its exchange rate, which had been fixed since the outbreak of the global financial crisis. These behaviours can be interpreted as signalling the intention to avoid becoming targets of US pressure along with Germany as a surplus state.[4]

4.1. Difference between China and Germany

How can we understand the different attitudes between China and Germany? It is certainly the case that China's active involvement in concerted expansionary policies was motivated by a desire to recover its domestic economy. For China, which had sought export-led growth for decades, cooperative efforts to boost world economic growth were undoubtedly beneficial. Nevertheless, China's behaviours cannot be fully captured in terms of material gains.

As mentioned above, international cooperation on macroeconomic policies has some aspects of collective action. Under the situation in which major states are affected by severe public debts, as has recently occurred, it is more likely that states have the incentive to free-ride on other states' fiscal expenditures. Further, it should be noted that states often try to transfer adjustment costs to one another in macroeconomic cooperation, because if states adjust their macroeconomic policies for international policy goals, the original domestic goal has to be at least partly sacrificed (Cohen 2006: 31-50). In these circumstances, surplus states in particular tend to receive foreign pressure to expand domestic demands for pulling the world economy out of recession, as they are seen to have the financial capacity to do so even during crisis periods. Japan, which suffered from the bubble economy and subsequent 'lost decades' from the 1990s onwards after faithfully following the logic of G5/G7 policy cooperation, is widely perceived as a typical example of having excessive adjustment costs imposed upon it. The Chinese media often warns their government not to make the same "mistake". With this distributional aspect of international policy cooperation being taken into consideration, it is plausible to argue that China should have acted more purely for its own economic self-interests, prioritising the minimisation of adjustment costs by carefully preventing overinvestment and the accumulation of public debts.

However, it is now evident that the amount of China's stimulus package far surpassed the optimum level for its domestic economy. As a result, a huge amount of money poured into local government financing vehicles and property developers, and harmful effects, such as property bubbles and excessive production capacity, have become glaringly obvious. A former minister of industry and information technology, Li Yizhong, pointed to the negative consequences of the stimulus package and claimed that it was necessary to draw lessons from their inexperienced crisis management (*Huanqiu Wang*, 7 March 2013).

To explain these behaviours, it needs to be understood that China was a norm demander in the issue of macroeconomic policy cooperation due to its relatively limited experiences in modern macroeconomic management. Throughout the process of international policy cooperation after the Lehman Brothers collapse, China seems to have attached considerable importance

to acknowledgement from the West and Western-led institutions. In fact, China tended to announce policy plans just prior to important international conferences, and thereby succeeded in being praised. In particular, China's announcement of a macroeconomic stimulus plan before the G20 Washington Summit was applauded by important figures in international policy circles, including IMF's Strauss-Kahn and US Secretary of State Hillary Clinton. In February 2009, the G7 finance group at Rome also stated: "We welcome China's fiscal measures and continued commitment to move to a more flexible exchange rate, which should lead to continued appreciation of the renminbi in effective terms". The fact that these praises were intensively covered by state-owned media points to China's high sensitivity to international reputation concerning its macroeconomic contribution (see, for example, *China Daily*, 25 June 2010). Moreover, China, though unintentionally, contributed to the correction of global imbalance by reducing its current account surplus by half since the global financial crisis.

These Chinese attempts to seek acknowledgement demonstrate that China accepted the norm of Keynesian policy cooperation. Therefore, it is not surprising that China occasionally went to the extent of threatening the stability of domestic economy in part due to its desire for international acknowledgement and self-acknowledgement about the conformity of its behaviour to the international norm. Indeed, such a perspective is also shared by Chinese actors. For example, a senior research fellow of the Chinese Academy of Social Sciences, Wang Tongsan, argued China's behaviours that received intensive international applause, namely the stimulus package for tackling the global financial crisis and the avoidance of devaluation during the Asian financial crisis, in the end turned into losses for China (*Shehui Kexue Bao* 1369, 2013: 1).

Chinese Premier Li Keqiang mentioned at the Summer Davos Forum in 2013 that China would contribute to the world economy with a stable growth rate and that the responsibility that China would take for the world economy should conform to the development level of the Chinese economy.[5] At the G20 finance group meeting in Sydney in 2014, Chinese finance minister Lou Jiwei also claimed that the current rate of China's contribution to world economic growth, around 30%, was already significantly higher than the share of the Chinese economy in world output, and it was impossible that the rate would reach 50% as it had during the period of the global financial crisis (*Renmin Ribao, Overseas Edition*, 26 February 2014: 2). These remarks seem to reflect the perception that China lost sight of domestic priorities by being inclined towards international acknowledgement during the period of global financial crisis.

In contrast, Germany has consistently prioritised its domestic policy goal. The fact that Germany was reluctant to participate in macroeconomic

cooperation, and often requested exit from it, seems to affirm its indifference to international acknowledgement based on the norm of Keynesian policy cooperation. When asked about the leadership in international policy co-operation that other European states expected Germany to exercise, Steinbrück expressed scepticism about the benefits of doing so (*Newsweek*, 152[24], 2008: 23). The continuous expansion of Germany's current account surplus may partly reflect its lack of intention to transform the economic growth model into a domestic demand-led one in accordance with the logic of international macroeconomic cooperation.

Why was Germany – unlike China, which faced similar pressure as a surplus state – relatively free from international normative constraints? The reason is mainly attributed to the fact that Germany was not a norm demander in the issue of macroeconomic cooperation. In other words, Germany had already established its own norms in making macroeconomic policy choices and therefore did not need to learn from international institutions. Germany's principled macroeconomic-policy norm is that anti-inflation should be prioritised over any other macroeconomic goal, including economic growth and employment. As is well known, this extreme conservatism derives from the historical experience of hyperinflation in the 1920s. Additionally, Germany's export-led growth model has some anti-Keynesian elements in that it needs in order to constrain the increase of prices and wages for export competitiveness (Blyth, 2013b: 48-49).

Ordoliberalism, a German variant of neoliberalism, which has been influential in German economic thinking, also deserves attention. Ordoliberalism takes seriously the role of the state and institutions in maintaining the order of the competitive market, although it is a liberal thought in terms of its fundamental reliance on market mechanism. In this respect, ordoliberalism departs significantly from laissez-faire liberalism. Notable ordoliberals such as Walter Eucken and Franz Böhm assume that a free market is vulnerable to rent-seeking activities and has a natural tendency towards inflation and market concentration. Therefore, the role of public institutions, particularly independent central banks and competition authorities, is essential for protection against these harmful effects (Sally, 1998: Part III; Bonefeld, 2012; Blyth, 2013a: ch. 5. See also, Foucault, 1997).

It is obvious that these economic beliefs are incompatible with Keynesianism, the core norm of international macroeconomic cooperation, since its essence is to artificially generate inflation to get out of recession rather than contain it. Owing to its established norms, Germany was able to refute or ignore international pressure to adopt policies that were incompatible with its own norms. Moreover, Germany can play the role of norm supplier for European states on the condition that its arguments are endorsed by regional institutions. At the beginning of the global financial crisis, Germany was

rather isolated, as support for Keynesian policy cooperation was strong among EU member states. Yet, as the German economy remained robust in stark contrast to other European economies, regional institutions such as the Frankfurt-based ECB gradually came to support the German-style conservatism. Just prior to the Toronto Summit, representative figures in EU-level policy choices, such as the ECB's Jean-Claude Trichet and European commissioner of economic affairs Olli Rehn, justified the strategy of fiscal consolidation with the intention of rejecting the US demand to expand fiscal expenditure (Financial Times, 24 June 2010: 2).

Support from these regional institutions made Germany appear not to be behaving for its self-interest only. This means that Germany had alternative institutional resources from which to derive legitimacy on policy choices and thereby was able to be relatively indifferent to the US or US-led institutions. In contrast, there was no equivalent institution for China, so its assertiveness would have been more readily interpreted as selfish or irresponsible.[6] In summary, the divergence of the two large surplus states' hierarchical positions depended primarily on the existence of their own norms and institutional resources that support those norms.

5. Conclusion

This article has examined the situation in which the prime factor that brought uncertainty into informal economic institutions was not the rise of Chinese state capitalism, as conventional wisdom suggests, but actually the disagreement among major advanced states. To address this paradox, we introduced a framework of normative hierarchy in informal institutions, showing that the paradox can be mainly explained by the power disparity between the major Western states and China, which was attributable to the asymmetrical allocation of normative and institutional resources in each issue area. As confirmed through case studies, the asymmetry in resource endowment led to different degrees of vulnerability to pressure and expectation manifested in the international institutional processes.

In the case of international banking regulation, the US, as a norm supplier, which is endowed with legitimacy and technical knowledge for policy choices, was able to give priority to domestic policy adjustments and repeatedly delay the implementation of the Basel regulations. Such actions remain threatening for the effectiveness of international regulations. In contrast, China, as a norm demander, which needed technical knowledge and legitimacy to achieve domestic policy reform and to increase the recognition of its banks in global financial markets, implemented international regulations much more rigorously. Such positive and faithful attitudes towards the international institution were not undermined, even in the phase where the

demanding requirements of Basel III were anticipated to negatively affect Chinese banks and the national economy, or in the case when the US delay of implementation of Basel III could have disadvantaged Chinese banks. It is noteworthy that uncertainty of the effects of the Basel regulations was recognised in China as well. From the above analysis, it is clear that China's attitude and behaviours cannot be reduced to material interests alone.

As for macroeconomic policy cooperation, Germany, which had established its own norms based on historical experience, was not a norm demander, meaning that it did not need to be authorised by the norm of Keynesian policy cooperation. This position enabled Germany to prioritise its own norms and policy goals and to supply them to other European states in those cases where it was supported by regional institutions. In China's case, there was no alternative source from which to draw legitimacy and technical knowledge. Therefore, the adoption of the Keynesian policy cooperation was an attractive choice. The fact that China took on a huge burden of adjustment costs, such as local government debts and an investment bubble, suggests that its policy choices cannot be captured only in terms of economic self-interest.

The above analysis allows us to propose two implications: the first relates to the broader theoretical debate on international relations and the second to the political economy literature on the rise of China and other emerging states. First, constructivist-based literature on international relations generally assumes that the formation of international institutions based on norm diffusion contributes to the provision of international public goods and promotes relatively equal interstate relations. In contrast, this study focuses on the importance of paying attention to the other side effects of the formation: it could lead to the maintenance and reproduction of asymmetrical interstate relations originating from an asymmetrical distribution of power resources.

Second, the impact of the rise of China on global economic governance after the financial crisis may be less significant than has often been thought. The establishment of the G20 leaders meeting and the enlargement of the Basel Committee, or the transformation of the Financial Stability Forum into the FSB, may appear to be a sharp disjuncture with US or Western-centred economic governance. At the same time, it is also possible that key normative and institutional resources are still exclusively held by the major Western powers in certain issue areas in which informal institutions play crucial roles as in the issue areas this paper addresses. The same points can conceivably be applied to other BRICS countries, since their power resources and overall economic size are much smaller than those of China. Given the increasing importance of informal institutions after the breakdown of the Bretton Woods system, we should be more sceptical about the popular narrative that a radical transformation of the power structure in global economic governance is already in progress.

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Notes

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1. Indeed, the negotiation over the capital adequacy ratio of 8% was said to be controversial, since the figure lacked enough theoretical and empirical support (Davies and Green, 2008: 38).
2. Based on the influential roles of US-based bankers' associations in the making of Basel II, it is widely regarded as a representative case of regulatory capture. See, for example, Mattli and Woods (2009: ix).
3. "'Full text' of Chinese President's Speech at G20 summit in Pittsburgh", *BBC Monitoring Asia Pacific*, 26 September 2009.
4. An official daily newspaper of the Shanghai Committee of the Communist Party carried an article arguing that it was welcomed that China did not become a topic of argument in Toronto. "Zhongguo meicheng huati" ("China did not Become a Topic"), *Jiefang Ribao*, 29 June 2010, p. 6.
5. "Text of Chinese Premier's Speech at Summer Davos Meeting in Dalian", *BBC Monitoring Newsfile*, 12 September 2013.
6. China's recent efforts to establish its own influential institutions like the BRICS Development Bank and the Asian Infrastructure Investment Bank can be seen as attempts to enhance institutional resources to support its norms and ideas.

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21 Shiji Jingji Baodao
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