"A Shift Towards a Gold Standard"? The FDIC-Fed's "Proposed Rulemaking" regarding Basel III Capital Requirements

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In early August, the FDIC1 and the Fed2 issued a "Notice of Proposed Rulemaking" stating that it intends to adopt the Basel III3 capital requirements. The document is 250 pages long and is available on line; http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20120607a1.pdf

It is important to analyze the potential implications of this document. Previous actions of the Basel Committee have had significant impact.

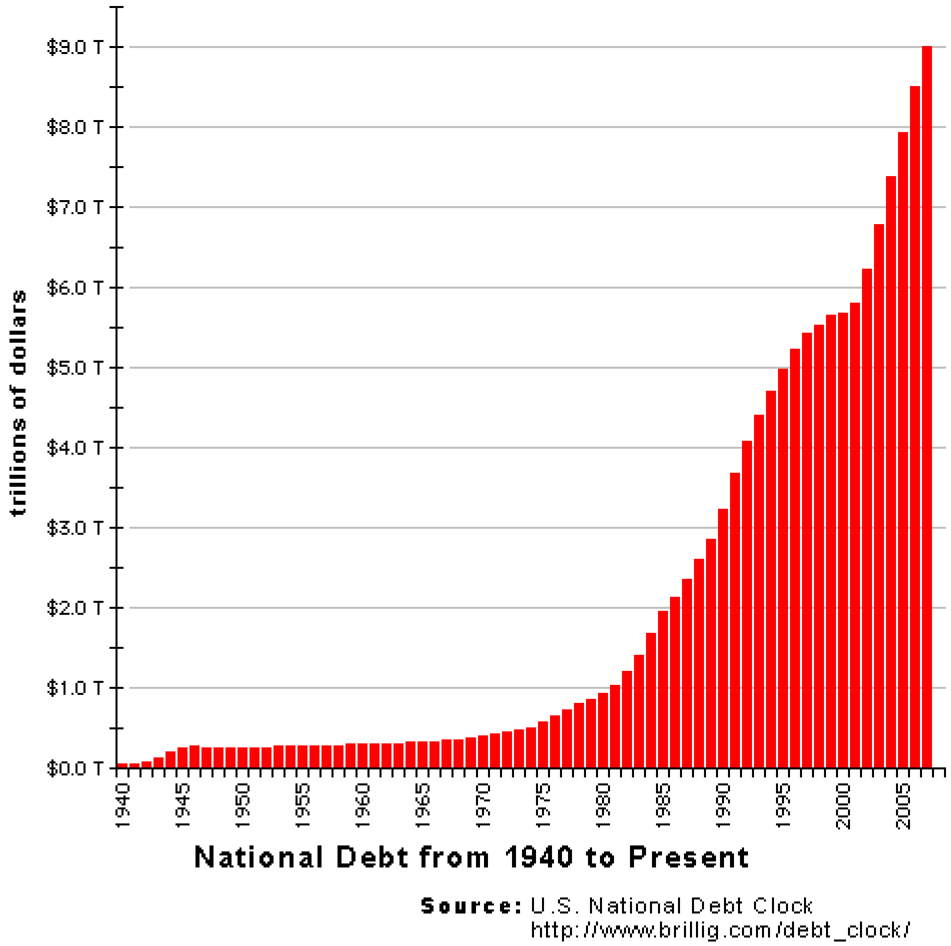
One commentator summarized this pending rule change this way; *'If this new rule is adopted as proposed, gold would shift… by the year 2015… (to) eventually place gold at the heart of global currency and payment systems — seemingly a shift back towards a gold standard. This action is a strong confirmation that gold's primary trend will likely continue.'*

A Brief History of the Basel Committee.

The central bank governors of the Group of Ten countries (Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, the United States, Germany and Sweden) meet from time to time. They signed the Smithsonian Agreement (Dec. 1971, the time of Richard Nixon) replacing the world's fixed exchange rate (IE a dollar is worth a fixed amount of gold) with a floating exchange rate. The effect of the agreement was the abolition of the US dollar's convertibility into gold making the dollar effectively a fiat currency (IE not backed by gold…. of no fixed value). The US went off the gold standard.

Again in 1974 the bankers met in Switzerland on the Rhine and established the Basel Committee on Banking Supervision; a committee of banking authorities to provide '…a forum for regular cooperation on banking supervisory matters'. Perhaps by coincidence but perhaps not, 1974 was the year in which the national debts of both the United States and Canada began to soar. It was the moment in history when, for some reason, both nations stopped printing money when they needed it and instead began to borrow it from the private banks. I've found no explanation for the identical policy change happening in both nations at the same time.

A quick scan of the chart below, especially noting the 30 years before the mid seventies meetings in Switzerland and 30 years after shows the result of the change in practice. The Canada chart is about the same.



The power of the Bank for International Settlements (sometimes called the bankers bank) to make or break economies was demonstrated in 1988, when it issued a Basel Accord raising bank capital requirements from 6% to 8%… Japan (was) the world's largest creditor; but Japan's banks were less well capitalized than other major international banks. Raising the capital requirement forced them to cut back on lending, creating a recession in Japan like that suffered in the U.S. today. Property prices fell and loans went into default as the security for them shriveled up. A downward spiral followed, ending with the total bankruptcy of the banks. The banks had to be nationalized, although that word was not used in order to avoid criticism.

Among other collateral damage produced by the Basel Accords was a spate of suicides among Indian farmers unable to get loans. The BIS capital adequacy standards required loans to private borrowers to be"risk-weighted," with the degree of risk determined by private rating agencies; and farmers and small business owners could not afford the agencies' fees. Banks therefore assigned 100 percent risk to the loans, and then resisted extending credit to these "high-risk" borrowers because more capital was required to cover the loans. When the conscience of the nation was aroused by the Indian suicides, the government … established a policy of ending the "financial exclusion" of the weak; but this step had little real effect on lending practices, due largely to the strictures imposed by the BIS…

Similar complaints have come from Korea. An article in the December 12, 2008 Korea Times titled "BIS Calls Trigger Vicious Cycle"described how Korean entrepreneurs with good collateral cannot get operational loans from Korean banks, at a time when the economic downturn requires increased investment and easier credit…

> "Chang Ha-joon, an economics professor at Cambridge University, concurs with the analyst. 'What banks do for their own interests, or to improve the BIS ratio, is against the interests of the whole society. This is a bad idea,' Chang said in a recent telephone interview with Korea Times."
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> Quote from an April 2009 article by Ellen Brown, The Tower of Basel

The Oxonian Revue wrote about (June 2012) a recent book entitled The Basel Committee on Banking Supervision and commented; '*If you want to explore why European banking is in a crisis today, how 29 "too-big-to-fail" banks have come to dominate global finance, and what motivates regulators and central bankers behind closed doors, then this tome is for you…. Reform of capital rules within the Basel Committee is not merely a … technocratic exercise, but an arena in which national interests, power politics, and bargaining between major financial centers come to the fore.*'

And more to the point is whose interests are going to be served by the Basel Committees upcoming rule changes? As always it will be the committee members; not the rest of us.

Notes

1. The Federal Deposit Insurance Corporation, the U.S. government agency that insures bank deposits in the US up to $250,000. http://www.fdic.gov/index.html
2. The Fed; the U.S. organization that Ben Bernankes speaks for which is the parent organization overseeing 12 regional 'feds' http://www.federalreserve.gov/otherfrb.htm The Fed is owned by private banks through an elaborate process. http://www.webofdebt.com/articles/time_to_buy_the_fed.php
3. Basel is the town in Switzerland where international meetings have been held on banking since 1970. The Basel Committee meets four times a year. Basel is also the headquarters of the Bank for International Settlements. http://www.bis.org/ Basel III occurred in 2010 and 2011 in response to the financial failures of 2008.