Trapped in the Spiral of Basel III. Tightening the Noose on Credit Spells Disaster

Punishing Your Local Bank for Wall Street's Misdeeds

By Ellen Brown

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The stock market shot up on September 13, after new banking regulations were announced called Basel III. Wall Street breathed a sigh of relief. The megabanks, propped up by generous taxpayer bailouts, would have no trouble meeting the new capital requirements, which were lower than expected and would not be fully implemented until 2019. Only the local commercial banks, the ones already struggling to meet capital requirements, would be seriously challenged by the new rules. Unfortunately, these are the banks that make most of the loans to local businesses, which do most of the hiring and producing in the real economy. The Basel III capital requirements were ostensibly designed to prevent a repeat of the 2008 banking collapse, but the new rules fail to address its real cause.

Why Basel III Misses the Mark

Two years after the 2008 bailout, the economy continues to struggle with a lack of credit, the hallmark of recessions and depressions. Credit (or debt) is issued by banks and is the source of virtually all money today. When credit is not available, there is insufficient money to buy goods or pay salaries, so workers get laid off and businesses shut down, in a vicious spiral of debt and depression.

We are still trapped in that spiral today, despite massive "quantitative easing" (essentially money-printing) by the Federal Reserve. The money supply has continued to shrink in 2010 at an alarming rate. In an article in *The Financial Times* titled "US Money Supply Plunges at 1930s Pace as Obama Eyes Fresh Stimulus," Ambrose Evans-Pritchard quoted Professor Tim Congdon from International Monetary Research, who warned:

"The plunge in M3 [the largest measure of the money supply] has no precedent since the Great Depression. *The dominant reason for this is that regulators across the world are pressing banks to raise capital asset ratios and to shrink their risk assets. This is why the US is not recovering properly."*

In a working paper called "Unconventional Monetary Policies: An Appraisal", the Bank for International Settlements concurred with Professor Congdon. The authors said, "*The main* *exogenous [external] constraint on the expansion of credit is minimum capital requirements*." ("Capital" means a bank's own assets minus its liabilities, as distinguished from its "reserves," which apply to deposits and can be borrowed from the Federal Reserve or from other banks.)

The Bank for International Settlements (BIS) is "the central bankers' central bank" in Basel, Switzerland; and its Basel Committee on Banking Supervision (BCBS) is responsible for setting capital standards globally. The BIS acknowledges that pressure on banks to meet heightened capital requirements is stagnating economic activity by stagnating credit. Yet in its new banking regulations called Basel III, the BCBS is *raising* capital requirements. Under the new rules, the mandatory reserve known as Tier 1 capital will be raised from 4 percent to 4.5 percent by 2013 and will reach 6 percent in 2019. Banks will also be required to keep an emergency reserve of 2.5 percent.

Why Is the BCBS Raising Capital Requirements

When Existing Requirements Are Already Squeezing Credit?

Concerns about the credit-tightening effects of Basel III were reported in a September 13 Huffington Post article by Greg Keller and Frank Jordans, who wrote:

"Bankers and analysts said new global rules could mean less money available to lend to businesses and consumers. . . .

"European savings banks warned that the new capital requirements could affect their lending by unfairly penalizing small, part-publicly owned institutions.

"'We see the danger that German banks' ability to give credit could be significantly curtailed,' said Karl-Heinz Boos, head of the Association of German Public Sector Banks.

"Insisting that French banks were 'among those with the greatest capacity to adapt to the new rules,' the country's banking federation nevertheless said they were 'a strong constraint that will inevitably weigh on the financing of the economy, especially the volume and cost of credit.'

"Story continues below

Juan Jose Toribio, former executive director at the IMF and now dean of IESE Business School in Madrid, said the rules could hamper the fragile recovery.

"'These are regulations and burdens on bank results that only make sense in times of monetary and credit expansion,' he said."

For smaller commercial banks and public sector banks (government-owned banks popular in Europe), the credit-constraining effects of Basel III are a serious problem. But larger banks, said Keller and Jordans, "were quick to praise the agreement and insisted they would meet the required reserves in time." The larger banks were not worried, because "*The largest U.S. banks are already in compliance with the higher capital standards demanded by Basel III, meaning their customers won't be directly affected*." Their customers, of course, are mainly large corporations. "Small businesses that rely on borrowing from community banks," on the other hand, "may be more affected . . . . They will try to make up for the higher capital requirements by lending at higher rates and stiffer terms."

If the big banks that brought you the current credit crisis can already meet the new requirements, what exactly does Basel III achieve, beyond shaking down their smaller competitors? As **David Daven** remarked in a September 13 article called "Biggest Banks Already Qualify Under Basel III Reforms":

"Indeed, on the day Lehman Brothers collapsed, THEY would have been in compliance with the Basel III standards."

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What precipitated the credit crisis and bank bailout of 2008 was not that the existing Basel II capital requirements were too low. It was that banks found a way around the rules by purchasing unregulated "insurance contracts" known as credit default swaps (CDS). The Basel II rules based capital requirements on how risky a bank's loan book was, and banks could make their books look less risky by buying CDS. This "insurance," however, proved to be a fraud when AIG, the major seller of CDS, went bankrupt on September 15, 2008. The bailout of the Wall Street banks caught in this derivative scheme followed.

The smaller local banks neither triggered the crisis nor got the bailout money. Yet it is they that will be affected by the new rules, and that effect could cripple local lending. Raising the capital requirements on the smaller banks seems so counterproductive that suspicious observers might wonder if something else is going on. Professor Carroll Quigley, an insider groomed by the international bankers, wrote in *Tragedy and Hope* in 1966 of the pivotal role played by the BIS in the grand scheme of his mentors:

"[T]he powers of financial capitalism had another far-reaching aim, nothing less than to create a world system of financial control in private hands able to dominate the political system of each country and the economy of the world as a whole. This system was to be controlled in a feudalist fashion by the central banks of the world acting in concert, by secret agreements arrived at in frequent private meetings and conferences. *The apex of the system was to be the Bank for International Settlements in Basel, Switzerland, a private bank owned and controlled by the world's central banks which were themselves private corporations*."

The BIS has now become the apex of the system as Dr. Quigley foresaw, dictating rules that strengthen an international banking empire at the expense of smaller rivals and of economies generally. The big global bankers are one step closer to global dominance, steered by the invisible hand of their captains at the BIS. In a game that has been played by bankers for centuries, tightening credit in the ebbs of the "business cycle" creates waves of bankruptcies and foreclosures, allowing property to be snatched up at fire sale prices by financiers who not only saw the wave coming but actually precipitated it.

Ellen Brown is an attorney and the author of eleven books. In Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free, she shows how the Federal Reserve and "the money trust" have usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are webofdebt.com, ellenbrown.com, and public-banking.com.

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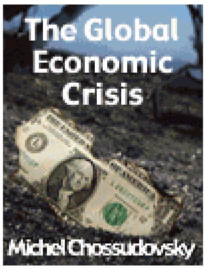

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