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Basel III, the Devil and Global Banking

Dimitris N. Chorafas

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Introduction

Whether we are talking about the economy, about finance, about social issues or about political themes, the challenge is to leapfrog ahead of a looming crisis that no person is big enough to start single-handed or powerful enough to stop. Acting ahead of the next bubble, and its consequences, is the task the Basel Committee on Banking Supervision took upon itself in December 2010. Regulating global banking is a demanding task, because:

- there is nobody who really knows how to carry out this near-miracle, and
- there is an abundance of adverse reactions from embedded interests which had profited handsomely from previous bubbles and wish to retain the status quo.

Regulatory reform cannot happen in an economic vacuum. Many market players are affected by it in different ways, and some will suffer adverse consequences. Biology provides a paradigm. Whenever the habitat of a species changes, there are both winners and losers.

Economic systems behave in a similar way. Therefore the obstacles to regulatory reform are political rather than technical. While, under the aegis of the Basel Committee, agreements on stronger capital requirements and new liquidity standards for banks have been reached quite quickly but, as the 81st Annual Report by the Bank for International Settlements (BIS) points out, there are still a number of critical steps to be addressed. According to BIS, these include:

- the full and timely implementation of Basel III,
- the elaboration of measures associated with systemic risk by big banks (and their adoption), and
- the design of regimes able to ensure the orderly resolution of big banks in cases where they fail.¹

The greatest of all challenges is quite likely to be an updated holistic view of global finance, its opportunities, its risks and the role played by increasing sovereign indebtedness. In no way should Basel III be considered a closed system of the banking industry, immune to the sea of red ink that surrounds it at sovereign, corporate and household levels. There is plenty of evidence of a closer than ever interconnection between:

- the global economy,
- the financing of government deficits,

- the financing of debts accumulated by private citizen, and
- the way the banking industry works.

An integral part of what still needs to be done in terms of taming the forces of globalized banking is the study and analysis of numerous lessons and legacies from the economic and financial hecatomb global economies have been going through since 2007. Central banks' monetary policies in the USA and Europe have come under close scrutiny as they have, *inter alia*, become a real and present danger to price stability. Overindebtedness and destabilization of the currency might superficially appear to be issues having little to do with Basel III, but in reality – for better or worse – monetary policy, fiscal policy and bank regulation and supervision correlate with one another.

The ultralight bank regulation and supervision that followed the repeal of the Glass–Steagall Act was flawed policy on the part of the US government, and it was also adopted by the UK and other member states of the European Union. The damage has been multiplied many times over by the acquired habit of citizens living beyond their means. The excuse that not thinking that something is wrong gives it the superficial appearance of being right is simply not acceptable.

Let's be clear on this. Time is running out for corrective action, far beyond what Basel III says. The market turbulence that followed the global big banks' descent into the abyss in 2008 would seem as nothing beside the devastation that would follow a major sovereign bankruptcy – and as far as this bubble is concerned, there are several candidates lining up to provide the trigger. If this bubble bursts, Basel III will be swept away in a moment and we shall be back again at point zero.

This sword of Damocles hanging over the global economy in no way diminishes the importance of knowing what the Basel III rules and modifications bring to the banking industry's economic habitat. The scope of the new regulatory regime is nicely described by a July 19, 2011 Basel Committee announcement. There are 28 systemic banks in the global market which must be watched with great care. The failure of any of them will trigger massive changes, not just in banking but also in the global economy.

* * *

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