

Central Bankers Preparing For Bank Failures

by John Hoefle

With banks and other financial institutions dominating the lists of the world's largest corporations, any talk of bank failures is bound to make people nervous. Great efforts are made to keep the public in the dark about the volatile nature of modern finance, and the frequency with which banks and banking systems blow up. Thus when both the Federal Reserve and the Bank for International Settlements begin speaking publicly on the subject, one had better pay close attention. Paying attention to what they say, however, should not be confused with believing what they say, because central bankers are almost genetically incapable of telling the truth. Watch them as you would watch a viper.

The bankers have a very big problem, as virtually every bank in the world is a bankrupt part of a now-bankrupt floating-exchange-rate monetary system. There are no safe havens, and no possibility of bailing out all the derivatives bets, worthless assets, and unpayable liabilities. With world productive activity in the tens of billions of dollars a year and financial claims in the hundreds of trillions, the banks, as the largest holders of financial assets in the world, are already gone. The only question left, is when to make the announcement.

It is in this context that the central bankers' discussions of bank failures, as well as their publicly questioning the concept of "too big to fail," must be evaluated. Though they phrase it as a theoretical discussion of future possibilities, the bomb they're holding in their hands is live, and ready to blow.

'Too Big To Fail'

The prospect of bank failures was one of the key topics discussed at the Chicago Federal Reserve Bank's 40th annual Conference on Bank Structure and Competition, held in Chicago May 5-7. Alfred Broaddus, the President of the Richmond Fed, raised the issue in the context of a discussion of

the "too big to fail" doctrine. Too big to fail really means too big to be allowed to fail, reflecting a policy in which the Government is either explicitly or implicitly expected to bail out any big bank which gets into trouble.

"Most banking analysts would agree that depositors and creditors of the largest banks are more likely to be protected in the event of financial troubles than their counterparts in small banks," Broaddus said.

As the banking sector continues to consolidate, he warned, the assets held by banks in the "too big to fail" category will expand.

As opposed to bailing out or arranging a takeover of every failed bank, Broaddus advocates letting some banks fail: "Promptly resolving large, troubled banks and imposing costs on uninsured creditors, even at the risk of some short-term financial disruption, is in my view the only means of eliminating the market's perception that large banks will receive special treatment should they become troubled," Broaddus said.

Minneapolis Fed President Gary Stern, who warned that "The seeds of serious bank problems are being sowed now," wrote a book on the dangers of bailing out every failing bank, entitled "Too Big To Fail: The Hazards of Bank Bailouts," released earlier this year.

String of Failures

While the Fed officials try to disguise their warnings as hypothetical possibilities, the Bank for International Settlements' Basel Committee for Banking Supervision released a study of past bank failures on April 29. The BIS report, entitled "Bank Failures in Mature Economics," details a string of "significant bank failures or banking crises during the past 30 years," noting that "central bankers fear widespread bank failures because they exacerbate cyclical recessions and may trigger a financial crisis."

The BIS report covers bank crises ranging from the 1973-

74 failure of the Herstatt bank in Germany; to the 1990s banking crisis in Japan, which included the 1998 collapse of Long-Term Credit Bank; the Norwegian crisis of 1988-1993; three separate waves of crisis in Spain from 1978 through the 1993 Banesto crisis; the Swedish crisis of the early 1990s; the 1991-1996 Swiss banking turmoil; three waves of failures in Great Britain during 1991-1995, including the failure of the Bank of Credit and Commerce International in 1995 and the 1995 collapse of the venerable Barings merchant bank; and the wave of U.S. banking problems from the 1984 collapse of Continental Illinois Bank, the late 1980s Texas banking and thrift crisis, and the 1991 failure of the Bank of New England.

To those who don't follow the subject, the frequency with which major banks blow up may seem surprising, but the truth is much worse than the sanitized BIS report admits. For example, the BIS says nothing about the Federal Reserve's takeover of Citicorp in 1991 or the takeover of Bankers Trust in 1994, and is discretely silent about the similar actions taken against J.P. Morgan Chase and Citigroup in 2001.

The BIS notes Delphically that "the process of financial liberalization (though not the financial liberalization itself) was a major factor in Spain, Norway, Sweden, and the U.S. S&L crisis," adding that the S&L crisis "was aggravated by insured depositors' confidence in their immunity from any losses."

Deregulation and Consolidation

The common thread which runs through the bank failures cited by the BIS, and the warnings being issued by the Fed officials, is the recurring pattern of deregulation, speculation and disaster. It is precisely this "financial liberalization" that is the problem. The BIS's assertion that it is the failure to adequately handle deregulation, and not the deregulation itself, is the lie which gives their game away.

To see the effects of "liberalization," one can compare the top ten banks in the United States in 1985, versus the top ten banks in 2003 **Table 1**. In 1985, the biggest bank in the U.S. was Citicorp, with \$174 billion in assets, and the top ten banks had just \$775 billion in combined assets. Compare that with today, where Citigroup has \$1.26 trillion in assets, and the top ten banks have a combined \$4.7 trillion in assets. The picture gets even worse when you consider that only one of the top ten banks in 1985 still exists today; all the rest have been taken over in mergers, many of them shotgun weddings arranged by regulators. Don't let the names fool you: The only survivor in the group is Chemical, which bought Manufacturers Hanover, Chase Manhattan and J.P. Morgan, and changed its name in the process. Citicorp was bought by Travelers, which became Citigroup, and Bank of America was bought by NationsBank, which kept the BoA name. On top of that, the list is already out of date, since Bank of America has acquired FleetBoston and Morgan Chase is buying Bank One, in a deal which will produce another trillion-dollar zombie.

TABLE 1

Top Ten U.S. Banks, 1985 and 2003

(Assets, \$ Billions)

1985	
Bank	Assets
1 Citicorp	174
2 BankAmerica	119
3 Chase Manhattan	88
4 Manufacturers Hanover	77
5 JP Morgan	69
6 Chemical NY Corp	57
7 Security Pacific	54
8 Bankers Trust NY	51
9 First Interstate	49
10 First Chicago	39
Total	775
2003	
Bank	Assets
1 Citigroup	1,264
2 JP Morgan Chase	771
3 Bank of America	736
4 Wells Fargo	388
5 Wachovia	401
6 Bank One	327
7 Taunus	291
8 FleetBoston	200
9 US Bancorp	189
10 ABN-Amro North America	127
Total	4,695

Source: Company reports.

The same process has occurred on a global scale, where many of the banks which topped the list in 1996 have disappeared into others **Table 2**. This is particularly true in Japan, where already huge and bankrupt banks have been merged into even larger giants. Germany's Deutsche Bank is bigger now than it was then, but has been shrinking over the past couple of years.

The extent to which these financial giants dominate the corporate world can be seen in the list published annually by *Forbes*. Of the 50 largest corporations in the world in 2003, ranked by assets, all but three are banks, insurance companies or other financial companies, and the three that aren't (General Electric, General Motors and Ford) have large financial arms which account for significant percentages of their assets. The *Forbes* list, published April 12, ranks Fannie Mae third and Freddie Mac thirteenth.

One might be inclined to think, looking at these impressive asset figures, that the banks are actually in fairly good shape. But when you consider that most of a bank's assets are made up of claims owed to the bank by others, the picture is not so rosy. In a world full of claims which cannot be paid, being among the biggest holders of IOUs is a dangerous position. There is not a single bank on that list which can stand against the storm which is brewing.

TABLE 2

Top World Banks, 1996 and 2003

(Assets, \$ Billions)

1996 Rank	Bank	Assets	Country
1	Bank of Tokyo-Mitsubishi	696	Japan
2	Deutsche Bank	570	Germany
3	Credit Agricole Mutuel	477	France
4	Dai-Ichi Kangyo Bank	454	Japan
5	Fuji Bank	453	Japan
6	Sanwa Bank	447	Japan
7	Sumitomo Bank	486	Japan
8	Sakura Bank	441	Japan
9	HSBC Holdings	402	UK
10	Norinchukin Bank	379	Japan
	Total	4,805	

2003 Rank	Bank	Assets	Country
1	Citigroup	1,264	USA
2	Mizuho Financial	1,116	Japan
3	Sumitomo Mitsui Financial	868	Japan
4	UBS	853	Switzerland
5	Mitsubishi Tokyo Financial	827	Japan
6	JP Morgan Chase	793	USA
7	Deutsche Bank	792	Germany
8	Barclays	792	UK
9	HSBC Group	758	UK
10	BNP Paribas	745	France
	Total	8,808	

Source: *Forbes*.**Shaping the Crash**

What the BIS and the Fed presidents are actually talking about is how to shape the crash. Fed Chairman Sir Alan Greenspan has publicly promised to bail out the giant derivatives banks, while Fed Gov. Ben “Bubbles” Bernanke has promised to print as much money as necessary to bail out the stock and bond markets; but even they realize that saving the system is not the same as bailing everyone out. The discussion of limiting the use of the “too big to fail” criteria is implicitly an admission that some banks will be allowed to fail, in order to save the system as a whole. The discussion about the lack of a Federal guarantee for Fannie Mae and Freddie Mac obligations is the same thing—even under the most optimistic scenarios, many investors are going to be cut loose, and the further you are from being an insider, the worse your chances. If you have to ask, you’re in trouble.

The Bank for International Settlements is essentially the central bank of the international financial oligarchy, which is planning to rule the world after the crash through their control over global corporate cartels. That is, they plan to return to the days when imperial corporations like the British East India Company and the Venetian Levant Company ruled large swaths of the world.