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Australia needs a new financial system, based on Glass-Steagall and a national bank

Summary

Australia faces a historic choice, of either sticking with the present financial system which is locked into the bankrupt financial systems of Europe and the United States, or participating in the emerging economic strength of the BRICS nations—Brazil, Russia, India, China, and South Africa—and their partner-nations in economic development.

If Australia sticks with the present system, modified by supposed reforms such as "bail-in", the Australian financial system is at risk of a complete meltdown in the next global financial crisis. International experts are warning that another global crisis is brewing that will be worse than 2008 due to the greatly-expanded level of global indebtedness and resurgence in risky derivatives speculation. Australia's banking system is concentrated in just four too-big-to-fail (TBTF) banks, and a globally notorious commercial/investment banking conglomerate, Macquarie Bank, which are all dangerously exposed to hyperinflated property values and related, rapidly-growing derivatives obligations. A crisis that crashes the domestic property market will wipe out the major banks.

If Australia chooses to participate in the new development opportunities emerging from the collaboration between the BRICS nations and others, it will revitalise Australia's productive economy. Two of the BRICS nations, China and India, are already among Australia's major regional trading partners. The BRICS have established international credit facilities committed to financing economic development projects. Russia has announced an intention to employ internal, sovereign credit to develop its economy; China and India already use sovereign credit from public credit institutions for internal economic development. Australia too should return to a sovereign credit system.

There are two specific measures that Australia must adopt to protect the population from the next financial meltdown, and establish a sovereign credit system that can finance economic development. The first is a full Glass-Steagall separation of retail banking from investment banking; the second is a national bank, based on the Hamiltonian credit system first developed in the U.S., and implemented previously in Australia using the original Commonwealth Bank.

Glass-Steagall will protect the functioning of the daily economy as the bubble of financial speculation implodes; perhaps more importantly, it will establish the principle that the only economic activity that warrants the support and protection of the government is that which is related to the productive physical economy, not the casino of financial markets. A new national bank will enable the government to direct credit into major public infrastructure projects, and productive industries, which strengthen and prosper the economy.

Threat of new global financial crisis

The FSI Interim Report refers to applying lessons from the 2008 global financial crisis. This is more urgent than the report acknowledges, because another, deeper and more violent financial crisis is looming.

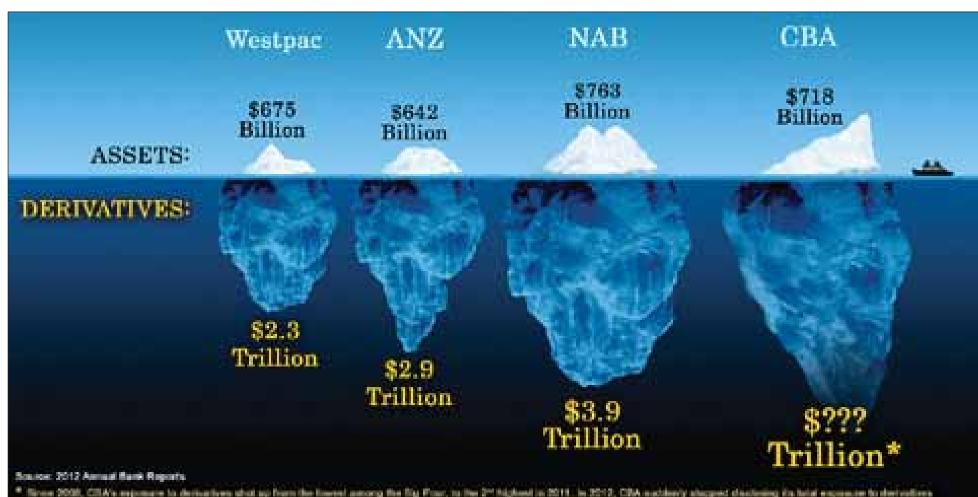
Presumably the well-connected bankers, business executives and academics on the FSI panel are already aware of the looming danger. There have been numerous warnings for a long time that the global debt situation is far worse now than in 2008. The latest information on this danger includes:

* The Bank for International Settlements' latest figures on over-the-counter (OTC) derivatives, the toxic instruments which blew out the financial system in 2008, which reveal that the general plateau and even small decline in total global OTC derivatives from 2008 to 2012 has ended. In the past 18 months global OTC derivatives have resumed the explosive growth that characterised the trade up to 2008, which is expected to be 20 per cent for the year. As of December 2013 the BIS semi-annual survey reports total notional amounts outstanding of $710 trillion. This figure only includes reported derivatives: analysts at *Executive Intelligence Review* magazine in the U.S., the world's experts in the danger of derivatives, estimate that total reported and unreported derivatives have now reached $2 *quadrillion* ($2,000 trillion).

* The 19 August *Financial Times* report entitled, "Investors dine on fresh menu of credit derivatives", which warns that a growing portion of the global derivatives trade is in variations of the same dangerous credit derivatives that caused the meltdown of Lehman Brothers and AIG in 2008. Hayman Capital Management's Kyle Bass, who published the first warning in 2007 that credit derivatives would bring down the system[1], is cited warning of another AIG. According to Janet Tavakoli, president of Tavakoli Structured Finance, "We've reformed nothing. We have more leverage and more derivatives risk than we've ever had."

* The procession of experts who are warning of an imminent crash, including former Bank for International Settlements chief economist William White, who told *Focus Money* 31 July that the world is still in the midst of the crisis and the worst is yet to come: "I think that the cause of the financial crisis was an excessive policy of cheap money combined with new financial products. This has led to a giant credit bubble, especially in the advanced economies. Since then, nothing has really changed. An active financial policy pumps the credit volume excessively like before, i.e., it does the same thing that has originally unleashed the disaster." Nikolaus von Bomhard, chief executive officer of the world's biggest reinsurer, Munich Re, has likewise warned that the expansive central bank policy called quantitative easing has reached its limit, and is coming to an "inflection point" now in Europe. London investment manager and columnist Liam Halligan wrote in *The Spectator* 26 July, "It strikes me, in fact, that the whole economic shebang is balanced on a cliff edge."

* The new phase of financial meltdown that has already started in Europe, with major bank crashes in Portugal, Austria, and Bulgaria, including Austria's Hypo Alpe-Adria bank, Portugal's failed Banco Espirito Santo, and Bulgaria's Corporate Commercial Bank—the latter two both have close ties back to the major French bank Crédit Agricole. The European Central Bank's "stress tests" are yet another factor, causing large Eurozone banks to attempt to sell off around $800 billion of toxic assets[2], to the only set of prospective buyers: the "vulture funds" currently trying to extort Argentina. Such funds purchase distressed debt at a few cents on the dollar, then demand payment of the full face value at a future date. A "Distressed Debt Investing Summit" took place in London on 18 September, with such funds focusing on the ample carrion to pick over in Europe.



* The latest RBA statistics which show that Australian banks' off-balance sheet obligations, which are mostly derivatives, are now more than $24 trillion[3]. The Big Four banks and Macquarie account for more than half of that exposure. It is repeatedly claimed that Australian banks' OTC derivatives are simple hedging, and not "dangerous", but that assumes the banks disclose their full positions in an area that is notoriously lacking in transparency. CBA and Macquarie Bank both refuse to disclose the total notional amount, or face value, of their derivatives[4], which is the relevant figure in a banking crisis; so-called "netting", which drastically reduces the derivatives liability figure down to the net margin of gain, assumes all banks meeting all of their obligations, and doesn't factor in Lehman-style bank failures and the resulting "contagion". The most worrying aspect of the derivatives exposure of Australia's banks, which contradicts the assurances that they are simple hedging derivatives, is their explosive growth since 2008. From 2008-12 when global OTC derivatives growth stagnated, the off-balance sheet business of Australia's banks skyrocketed from $13 trillion to $19 trillion, and is now $24 trillion—most of that, $18.8 trillion, is OTC derivatives. The fastest growth was that of Australia's biggest and supposedly most profitable bank, CBA, which suddenly stopped disclosing its full position in 2012 after a dramatic increase in its derivatives contracts.[5]

Regardless of the actual risk in terms of the derivatives exposure of Australia's banks, another global financial crisis will severely impact Australia's financial system in any number of ways. Australia is most vulnerable to a meltdown of the domestic housing market, which has been exceedingly over-inflated for more than a decade. Not so much if, but *when*, it crashes, as every other housing bubble in the world has crashed, it will wipe out Australia's major banks, which are terminally exposed to these inflated property values.[6] The Citizens Electoral Council elaborated this risk in its first submission to the FSI on 1 April, in the Appendix entitled *Memo: The Great Australian Mortgage Bubble*.

Alternative international responses

FSI Chairman David Murray has repeatedly stated that Australia must align with international financial developments.[7] In fact, Australia should stand as a sovereign nation which only cooperates with international measures that benefit the people of Australia.

There are two contrasting international responses to the economic crisis: the U.S.-European bailout/bail-in of TBTF banks to preserve the globalist system; and the emerging commitment of certain nations around the BRICS (Brazil, Russia, India, China and South Africa) to reorganise their financial systems to ensure they invest in physical economic development that raises national livings standards.

Bailout/bail-in

To date, the governments, central banks and financial authorities of the U.S. and Europe are committed to preserving the system of deregulated, globalist mega-banks which caused the present crisis. When the crisis first hit they sprang into action to bail out the TBTF banks, and imposed brutal austerity measures on their citizens essentially to pay for the bailouts while letting the bankers off scot-free in terms of criminal sanctions for their crimes which caused the crisis. Through the G20 they have since embarked on establishing the radical new bank resolution regime called bail-in, to further entrench the global and domestic TBTF banks.

Bail-in is a fraud. It is presented as the solution to TBTF banks requiring taxpayer bailouts. TBTF banks only require taxpayer bailouts because they are *too big*—they are multinational banking conglomerates which often combine retail banking, investment banking, insurance, stockbroking, funds management and other financial services. This exposes the deposits in the retail side of the banks to the risks that the investment and other divisions of the bank incur; 2008 demonstrated that the derivatives speculation which dominates investment banking can destroy the financial system. Bail-in does nothing to address the size and conglomeration of the banks. Rather, it forces a bank's unsuspecting customers and other unsecured creditors to wear its losses so the bank can continue to operate as a conglomerate, and continue to honour its obligations to its derivatives counterparties in other banks.

Bail-in as imposed by the European Central Bank and European Commission, devastated the Cyprian economy in March 2013. It destroyed consumer confidence in banks—which is the essence of banking—triggering predictable bank runs that forced the authorities to impose a liquidity freeze involving severe restrictions on daily bank withdrawals. The economy ground to a halt, and unemployment skyrocketed.[8] The European Commission has since established a Europe-wide bail-in regime. France, Germany, the U.S., Canada and Japan, to name some leading nations, have all enacted bail-in laws.

This Financial System Inquiry received submissions on bail-in in the first round, from the CEC, as well as from institutions such as the Treasury. It is an established fact that before the current Treasurer commissioned this FSI, indeed before this present government was elected, plans existed to legislate bail-in for Australia. The Financial Stability Board (FSB), which operates out of the Bank for International Settlements in Basle, Switzerland and which the G20 in 2009 charged with overseeing the implementation of bail-in among G20 member nations, revealed in its 15 April 2013 report to the G20 entitled *Implementing the FSB Key Attributes of Effective Resolution Regimes—how far have we come?*, that bail-in "legislation is in train in some jurisdictions (including Australia..." and six other nations in addition to the EU. This was unequivocal, and it followed numerous other references to Australia implementing bail-in made in official reports of the IMF and the Australian Treasury in 2012.

This would indicate that plans for an Australian bail-in law are advanced. Yet, under questioning by the CEC and members of the public, representatives of the present government have repeatedly denied any such plans. The FSI interim report discusses bail-in as just a possible option. The CEC is compelled to question whether this is a political charade, given the post-Cyprian notoriety of bail-in?

Later, this submission will demonstrate that the present Financial Claims Scheme deposit guarantee makes bail-in a necessity for Australia's Big Four banks, unless the government implements a full Glass-Steagall banking separation.

The BRICS credit systems to fund economic development

The alternative to the trans-Atlantic economies' policy of preserving the size and power of the system of TBTF banks is to create a financial system that directs credit into physical economic development projects which uplift national living standards, to which the BRICS nations—Brazil, Russia, India, China and South Africa—and their collaborators are committed.

The 14-16 July BRICS summit in Fortaleza, Brazil concluded with a 72-point Fortaleza Declaration which proclaimed, "We call for an international financial architecture that is more conducive to overcoming development challenges." That summit established the New Development Bank (NDB)—an alternative to the U.S./European-controlled World Bank—with a start-up capital of $50 billion, which the Declaration stated is to mobilise resources for infrastructure and other development projects in BRICS and other developing economies; the NDB is to be headquartered in Shanghai, China. The BRICS also established an alternative to the IMF called the Contingent Reserve Fund, initially capitalised at $100 billion, to "help countries forestall short-term liquidity pressures". China, the largest BRICS economy, has invited India, Thailand and other Asian nations to create an Asian Infrastructure Investment Bank (AIIB), with $50 billion capital from governments and another $50 billion from other sources, which will be dedicated to funding infrastructure.

Both in keeping with the BRICS developments and under the necessity forced by the sanctions on its economy, BRICS member Russia is planning to shift to a sovereign credit system. Russian economist Sergei Glazyev, an adviser to President Vladimir Putin, told *Bloomberg* on 9 August of his nation's "plan for fast-track development of the Russian economy on the basis of a new technological order. This plan includes a *transition to a sovereign monetary system underpinned by internal sources of credit*, an active policy of innovation and support for progress in science and technology." [Emphasis added.] Ironically, the U.S.—the source of the sanctions on Russia—invented and pioneered the sovereign credit system that Russia is planning, under the first U.S. Treasury Secretary Alexander Hamilton and later U.S. presidents such as Abraham Lincoln, as did Australia, another nation sanctioning Russia, with the original Commonwealth Bank.

A current working example of sovereign credit being directed into development is Egypt, which on 6 August commenced construction on a second Suez Canal to double the capacity of the first, the world's most important seaway.[9] While in Australia investment banking-connected politicians are pushing the privatisation of assets and public-private partnerships as the only way to attract the foreign capital to fund new infrastructure, Egypt is funding this massive project entirely internally, by issuing debt certificates to Egyptian citizens, denominated in the Egyptian currency. While the European system of financial austerity has driven youth unemployment in Spain and Greece as high as 60 per cent, the Egyptian Armed Forces Engineering Authority, which is supervising the construction of the second canal, has called on *all* unemployed Egyptians under 45 to sign up for jobs on the project. Egypt is also forging closer ties to the BRICS nations: Chinese Foreign Minister Wang Yi visited Egypt on 3-4 August, inviting Egypt to join in China's transcontinental New Silk Road infrastructure vision. Egypt's President Abdel Fattah al-Sisi travelled to Sochi, Russia on 12 August for a two-day summit with President Putin, which discussed cooperation on trade, nuclear and hydroelectric power development, and space exploration.

As with the BRICS nations, Egypt has given firm support to the nation of Argentina in its dispute with the so-called vulture funds and the U.S. courts which are enforcing their claims. The Argentinian case typifies the widening gulf between those nations which are asserting their sovereignty over financial institutions, and the trans-Atlantic economies of the U.S. and Europe, and Australia, which continue to accept the authority of financial institutions and markets[10] to demand policies such as austerity and bail-in.

CEC recommendations to FSI: Glass-Steagall, and a national bank

Australia needs a financial system that can safeguard the population against future financial crises and finance the economic development necessary for the nation to prosper. The CEC recommends that Australia take its lead from the practical measures which the BRICS nations and their collaborators are implementing to achieve this goal. Australia should also look to examples from its own history.

But first, Australia must emphatically reject any suggestion of a bail-in regime that makes depositors and other unsecured creditors liable to prop up failing TBTF banks. The specific bail-in measure must be rejected, as well as the principle behind bail-in which is also the principle behind budget austerity—that the functioning of the financial system is pre-eminent in the economy, above the welfare of the people. Pope Francis in his *Evangelii Gaudium* urged the rejection of "the absolute autonomy of markets and financial speculation", charging, "Such an economy kills."

To secure an Australian financial system that is based on the principle that the system serves the needs of the people, and ensures Australia's ongoing economic development, Australia must implement a full Glass-Steagall separation of retail banking from investment banking, and return to national banking.

Glass-Steagall

The only way to truly protect the vital functions of Australia's banking system is through a full Glass-Steagall separation. When the U.S. *Glass-Steagall Act 1933* separated out investment banking and other financial services from commercial banking, it brought an end to the run of thousands of bank collapses in the U.S., and initiated a five-decade period of virtually no bank crises in that nation until the 1980s, when the deregulation of Savings and Loans banks exempted the sector from conforming to Glass-Steagall, which triggered the collapse of S&Ls within a few years. Likewise, after some watering down in the 1980s and 1990s, the full repeal of the *Glass-Steagall Act* in 1999 triggered the flood of mergers and acquisitions and increased speculation that led to the 2008 GFC, and the conundrum of the banks being TBTF.[11]

Presently, Australians are told their deposits in the banks are protected by the Financial Claims Scheme (FCS) up to $250,000, which covers 99 per cent of all bank accounts, and around 50 per cent of total deposits. However, around 80 per cent of all deposits are in the Big Four banks. This makes the FCS unworkable in terms of those four banks, because the FCS only makes provision for $20 billion per Authorised Deposit-taking Institution (ADI) to pay out deposits, with the balance to come from a levy on the industry. Given that the Big Four banks each hold around $400 billion in deposits, of which presumably around 50 per cent, or $200 billion each, are guaranteed by the FCS, it is obvious that in the event of a collapse of one of the Big Four, the $20 billion FCS provision won't be sufficient to pay out the deposits. That means that an industry levy would need to raise $180 billion, which raises the question: how would it be at all possible for a levy to raise that much money, from the Australian financial system?

If it is claimed that the bank would be put through receivership and its assets sold up and the returns distributed to its creditors, among whom depositors have preference, thus decreasing the amount the FCS would need to cover, that argument downplays: a) the Australian banks' heavy use of covered bonds, the claims on which come *ahead* of depositors; and b) the likelihood that, given that the Big Four banks are very similar businesses, and have similar over-exposure to a collapse of the housing bubble, a crisis in one will be a crisis in all, raising the prospect of a general banking crash which will annul all ostensible guarantees.

The unworkability of the FCS in relation to the Big Four banks is another aspect of their being TBTF, and requiring a bail-in if they face collapse, so that they never go into a liquidation in which the FCS will be proven inadequate.

The far better, and indeed *only* way to guarantee deposits in all of Australia's banks is through Glass-Steagall, which separates the deposits from any activity that would put the bank at risk. It is notable that the U.S. Glass-Steagall regime, which also created the U.S. Federal Deposit Insurance Corporation (FDIC), enabled commercial banks to hold relatively less capital than otherwise, because commercial banking activity was so demonstrably safe. This allowed for more credit to be directed into economic activity.

Under an Australian Glass-Steagall separation, the Big Four banks and Macquarie Bank would be split up into completely separate retail and investment banks, with different ownership and management. Government guarantees would only cover the new retail banking institutions; the new dedicated investment banks will know they will sink or swim on their own. Experts recommend a transition period, anywhere from two to five years, for the banks to separate, and unwind the derivatives and other investment positions that are connected to the retail part of the bank.

FSI chairman David Murray has already mooted the possibility of ring-fencing the banks, acknowledging the conflict of cultures, and also interests, between retail and investment banking. However, ring-fencing is a fraud. It is the compromise for which City of London bankers lobbied that country's Vickers Commission, in order to deflect the concerted post-GFC push for a full Glass-Steagall separation. Ring-fencing gives the appearance of separation, while still keeping retail banks and their deposits in a vulnerable position where investment bankers in the same group can try to access their capital. Esteemed members of the U.K. House of Lords, including former Chancellor of the Exchequer Lord Lawson, pointed out in a 26-27 November 2013 debate that ring-fencing isn't a sufficient separation, and that investment banks will naturally attempt to get around it; "bankers are extremely adept at getting between the wallpaper and the wall", former investment banker Lord Forsyth of Drumlean declared. Another relevant fact is that U.S. banks were effectively ring-fenced prior to the 1929 stock market crash and Great Depression; it didn't stop them from engaging in the crimes exposed by the 1932-34 Pecora Commission[12], only Glass-Steagall did. By mooting ring-fencing, Chairman Murray has acknowledged the problem—the FSI panel should recommend the only real solution, a full Glass-Steagall separation.

Australian opponents of Glass-Steagall argue that Glass-Steagall isn't relevant to Australia's major banks, because, apart from Macquarie Bank, investment banking is a much smaller part of their operations than is the case in banking conglomerates in other countries. That may be; however, investment banking is known to be very profitable for the Big Four banks, profitability that the banks are doubtless keen to retain, which reinforces the intrinsic conflict of interests. Moreover, all of the Big Four and Macquarie have been involved in banking scandals in recent years, in which bank-employed financial advisers talked retail customers into buying margin loans and other risky investment products, which cost thousands of Australians their life-savings and their homes. These are largely unresolved scandals for which the banks are yet to be fully held to account. The banks blame the

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