

# How shenanigans could have been avoided altogether

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From Mr Thomas Lines.

Sir, John Gapper has reached "a damning verdict" on two decades of capital adequacy regulation under the Basel accords ("[How banks learnt to play the system](#)", May 7); while Matthew Richardson and Nouriel Roubini ask why we should keep insolvent banks afloat ("[Insolvent banks should feel market discipline](#)").

The Basel framework was a response to the weakness of international banks during the debt crisis that followed Mexico's near-default in 1982. There was much talk about the "moral hazard" of letting indebted countries get away without meeting all their obligations. At the time the same principle was little applied to the banks, which had lent billions to borrowers that proved unable to repay. In any other area of business in a market economy, such errors of judgment would be severely punished.

I examined the rules of the game (prudential regulations, debt renegotiations, lender of last resort facilities, accountancy rules, the role of auditors and tax incentives), and found that they overwhelmingly benefited international creditors at the expense of debtors, although the crisis arose from mistakes on both sides. One of my conclusions was that "the effective guarantee against bankruptcy provided to major banks ... should be called into question and probably abandoned" (Development Policy Review, September 1989).

Because of those rules, the main costs of the debt crisis were borne by the poor countries, and many of the poorest citizens within them. It is only recently that many of those countries have begun to recover from it. If in 1988 Profs Richardson's and Roubini's suggestion had been pursued, and not the Basel programme, some banks might have fallen but it would have caused much less disruption in the rich world than there is now, because the crisis was more contained. Afterwards, the banks would have had to be more circumspect in their behaviour and the shenanigans of recent years might have been avoided altogether.

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