

## **The impact of Basel I capital requirements on bank behavior and the efficacy of monetary policy**

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### **Abstract**

*The paper attempts to investigate the influence of the 1988 Basel Accord on bank behavior and monetary policy. It is argued that the Accord was successful in that it forced commercial banks in all of G-10 countries to maintain higher capital ratios. Tentative research suggests, however, that – at least among American banks – the Accord also encouraged the widespread resort to regulatory capital arbitrage techniques, in particular securitization. The paper also reviews the literature on the transmission mechanism of monetary policy and shows that the Basel Accord has affected the bank lending channel.*

**Keywords:** Basel Accord, Capital Ratios, Bank Regulation, Monetary Policy

**JEL classification:** E51, G28

### **1. Introduction**

After the spectacular collapse of two large international banks, Long Island's Franklin National Bank in the US<sup>1</sup> and Bankhaus Herstatt in Germany in 1974, monetary authorities and policy makers throughout the world decided that the increasingly more common cross-border capital flows and the resulting integration of financial markets that had been going on for some time, required a new global regulatory framework which would help ensure the stability of the international financial system. In particular, it became obvious that even though the prudence of domestic banks might be secured via home country regulations, the international activities of these banks lacked proper

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<sup>1</sup> The fall of FNB, whose insolvency had been covered up for a few years by fraud, falsification of records, bribery, and embezzlement of its major shareholder and mafia figure Michele Seldona, constituted the greatest bank failure in the history of American banking, up to the unfolding of the current crisis. DeWan (2008)