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Banking by William Jones

Gestapo tactics to enforce S&Ls plan

Savings and loan managers are accused of fraud, but the real fraud is the policy which led to the crisis.

The sweeping reform of the savings and loan system promised by the President in his speech before the Joint Session of Congress on Feb. 9, was made more concrete in testimony by Treasury Secretary Nicholas Brady before the Senate Banking Committee on Feb. 22.

Brady's testimony showed that the Bush administration has decided to target scapegoats among the managers of the S&Ls, to blame for the breakdown of the economy as a whole. For Brady, the cause of the crisis is not the failure of government economic policy during the last 10-20 years, but rather the evil-doings of the "high-fliers" who "used their institutions to finance their lavish lifestyles" and to "engage in speculative and fraudulent business activities." Fraud is the cause of the chaos in our financial institutions, according to this former Wall Street broker.

The Bush administration intends to nail its scapegoats to the wall. "Our proposal," said Brady, "will add new enforcement authorities, increase penalties for fraud, and increase funding to provide for dramatically increased law enforcement staff and prosecutions. . . . Maximum civil penalties will be raised to $1 million per day, and maximum criminal penalties to 20 years, with mandatory minimum sentencing. Authority will also be provided for regulatory agencies to pay rewards to informants."

In a word, police-state measures will "rectify" what government mismanagement has caused.

Brady also upped the ante on the cost of the S&L "bailout," adding $24 billion to the $90 billion estimate announced earlier by the Bush administration. The new figure includes the estimated cost for S&Ls which will become insolvent in the 1990s. The total cost for the rescue is now estimated at $157.6 billion.

The real costs will undoubtedly be much higher than anybody today is willing to admit. The Treasury Department estimates rest on highly optimistic but untenable assumptions concerning the future course of interest rates, inflation, and savings deposits. The high inflation figures released in February, which sent the stock market plummeting 40 points, bode ill for the Brady estimates. Although President Bush insists that there is no need for raising interest rates at the present time, such a trend has already begun, and will further push up the price of the "rescue" package.

The administration has backed down on several issues after heated criticism from banking circles. For example, the maximum allowable insurance premium charged to banks will be half that proposed in the original plan.

The administration's savings and loan plan consists of three separate financing elements: $40 billion to pay for the closing of 220 institutions in 1988 by the Federal Home Loan Bank Board, $50 billion over the next three years for closing 500 associations that are insolvent now, and $24 billion for insolvencies between 1992 and 1999. Since some of the money will be financed through $50 billion in borrowings, there will also be a considerable expense for interest. Treasury maintains that the cost for the taxpayer will be $60 billion, but private analysts say it could go as high as $90 billion.

Although selling off insolvent S&Ls to the commercial banks at bargain-basement prices will resolve some bookkeeping problems associated with the cancerous growth of speculative debt represented by the S&L high-risk boondoggles, serious problems will arise for the entire financial system.

The central focus of the Bush reforms is to merge the FSLIC, the insurance organization for the savings and loan institutions, with the FDIC, the organization responsible for insuring the commercial banks. In this way it is hoped that the somewhat more financially stable FDIC would restore confidence in a revamped savings and loan system.

The effect of the merger could, however, have precisely the opposite effect. The shutting down of the S&Ls has already threatened runs on the targeted institutions. If the same institution which insures the S&Ls also insures the commercial banks, this may cause a general loss of depositor confidence and a run on the commercial banks. This is particularly a danger with regard to foreign depositors.

Treasury Secretary Brady tried to assuage nervous commercial banks that they would not be in danger, by assuring them that the "separate insurance funds will not be commingled, and premiums from each industry will be used only for its own insurance fund."

At the same time, Brady hedged on the question of whether the revamped S&Ls will be able to display the seal of the FDIC, thus assuring that their deposits have the full backing of the U.S. government. Brady punted on the issue, saying that that decision should be left up to the Congress.

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