

Banking by John Hoefle

A house of credit cards

Bush's call for a cap on credit card rates generated an uproar that exposed the insolvency of the banking system.

President George Bush and the U.S. Senate have demonstrated to the world that the U.S. banking system is totally insolvent.

The President told a New York audience on Nov. 12 that he "would frankly like to see the credit card rates down." Taking Bush's call to heart, Republican Sen. Al D'Amato of New York the next day introduced a bill to cap credit card interest rates at 14%. The Senate passed the bill by a vote of 74-19, and members of the House promised a similar bill.

The Bush/D'Amato measure set off a firestorm of protest by the big banks, bank regulators, and major retail card issuers, who rushed to Capitol Hill to defeat the plan. At stake, they howled, was the very existence of the banking system.

They were right.

Over the past two years, credit card profits have accounted for some 25% of the reported profits of U.S. banks as a group. Of the claimed \$15.6 billion profits in 1989, some \$4.1 billion was attributed to credit cards, and credit cards were responsible for \$4 billion of the claimed \$16.9 billion profits in 1990. The emphasis is on the word *claimed*, since in reality the U.S. banking system has been losing money at an accelerating rate, while reporting nonexistent profits through fraudulent bookkeeping.

The Federal Reserve's repeated dropping of interest rates has in part been a back-door bailout of some of the country's largest banks. The big banks have maintained their near-20% interest rates on credit cards, and high rates on other loans, even as their cost

of deposits has plummeted. Each 1% increase in the spread between what banks pay for deposits and what they charge their customers gives the insolvent banks an estimated \$1.5-3 billion in badly needed income.

Take away this looting operation, and the banks would collapse overnight.

Faced with imminent catastrophe, the banks threatened to cancel half of their 120 million credit cards, raise the annual fees on the remaining cards, eliminate the interest-free grace period, and raise the fees they charge merchants.

"We're not threatening," insisted Philip Corwin, director of operations and retail banking for the American Bankers Association. "We're just telling what we're going to have to do."

The Bush administration, realizing the panic such actions would cause, quickly reversed its position—and clumsily tried to shift the blame to Congress. President Bush insisted that while he still favored lower rates, he was opposed to the irresponsible legislation. White House Press Secretary Marlin Fitzwater said that the legislation "could be quite disastrous to the banking industry." "This is wacky, senseless legislation," said Treasury Secretary Nicholas Brady, and Council of Economic Advisers chairman Michael Boskin called the measure "economically dangerous." Vice President Dan Quayle threatened an administration veto if the measure passed Congress. Federal Reserve chairman Alan Greenspan warned that the measure would have a "negative effect on banks' earnings" at a time

when there are already "concerns about capital positions."

What they were all saying, in effect, was, "The banks are already bankrupt and will not survive this action."

Tennessee Democrat James Sasser, a senior member of the Senate Banking Committee, put it more bluntly: "The thought around here is that Citicorp might go under, and that millions of folks would lose their credit cards, and that is causing a lot of wringing of hands and gnashing of teeth."

The brain-dead Citicorp, the nation's largest bank and largest issuer of credit cards, is already bankrupt, and reportedly has been unofficially seized by the U.S. government. Were the government to admit that Citicorp had failed, many of the bank's 20 million credit card holders would panic, as would the merchants who take those cards. The result would be massive runs against Citicorp, which would quickly spread to other banks and bring down the entire house of cards.

The failure of Citicorp would also immediately collapse the \$60 billion market in credit card-backed securities, of which Citicorp's share is \$19.6 billion. Trading in this mortally wounded market ground to a halt after the Senate action, shutting off another source of cash for the big banks, and blowing another hole in the financial markets similar to the 1989-90 collapse of the junk bond market.

The administration and Congress have dropped the idea of a credit card rate cap, but the damage has already been done.

As the Swiss bankers' daily *Neue Zürcher Zeitung* commented on Nov. 19, Bush's desperation moves, such as the credit card gambit, indicate that the President "appears to have completely lost his nerves, and reminds one of a headless chicken."