Banking by John Hoefle

Bailout money goes to maintain bubble

The money for the savings and loan bailout is actually going to save the banks and support the financial bubble.

In testimony before the House Banking Committee on March 16, Treasury Secretary Lloyd Bentsen asked Congress to approve an additional $45 billion to deal with bankrupt savings and loan institutions. Bentsen repeated his request the next day to the Senate Banking Committee.

"There has been a lot of confusion about this program," Bentsen told the senators. "It has been labeled a 'bailout.' That is dead wrong. . . . Not a dollar has gone to 'bail out' bankrupt S&Ls or to pay off their shareholders."

Bentsen was telling only part of the truth: The so-called S&L bailout is not a bailout of the S&L system, but of the banking system and the financial speculators.

The speculative frenzy which destroyed the S&Ls began in 1982, with the passage of the Garn-St Germain Depository Institutions Act. Prior to Garn-St Germain, S&Ls were restricted to making mostly home mortgage loans. By throwing out these restrictions, Garn-St Germain opened the floodgates, and the speculators rushed in.

The fast-buck artists began investing in all sorts of speculative activity, from real estate to junk bonds. As the bubble grew, these thrifts made huge apparent profits, prompting other thrifts to get into the act. But these profits were illusory, and by the late 1980s, the high-flying thrifts were beginning to crash and burn.

Having served their purpose by pumping up the real estate and junk bond markets for half a decade, these looted thrifts were then taken over by the government, in what has become known as the "S&L bailout."

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Firrea—the so-called S&L bailout law) was not, as Bentsen correctly noted, designed to rescue the thrifts. Its purpose was to transfer the best assets of the S&Ls, and their $1.2 trillion in deposits, to the big commercial banks and their allies, while sticking the U.S. taxpayer with the losses.

"You're going to see a real buying spree by commercial banks of S&Ls over the next few years," thrift analyst Bert Ely warned in July 1989.

By June 1990, less than a year after the signing of Firrea, the newly created Resolution Trust Corp. had sold 110 failed thrifts. Eighty-one of them had been bought by banks. NCNB Texas, the bank created when NCNB Corp. of Charlotte, North Carolina bought the remains of the failed First RepublicBank Corp. of Dallas, purchased 18 of those thrifts, boosting its assets by $7 billion to $33 billion, making it twice as large as its nearest Texas competitor.

NCNB went on to acquire the ailing C&S/Sovran, transforming itself into NationsBank, the fourth largest bank in the United States, and a prime example of the effects of Firrea.

By May 1992, ten of what had been the 25 largest thrifts in the country five years earlier—including Financial Corp. of America, Crossland Savings and Goldome—were out of business or under government control. Those 10 thrifts once held 40% of the assets of the top 25. During that five-year period, the number of U.S. thrifts fell by 30%.

Between the passage of Firrea and mid-1992, commercial banks acquired some $171 billion in thrift deposits. Were all those deposits to have been put into a new bank, that institution would have the largest deposit base of any bank in the country. By comparison, at the end of 1992, Citicorp had $144 billion in deposits, BankAmerica had $138 billion, Chemical had $94 billion, and NationsBank had $83 billion.

Firrea also reintroduced lending restrictions and tougher capital standards for thrifts, forcing them to sell assets in order to raise their equity capital-to-assets ratio. The effect of this was to force thrifts to sell their best assets, while keeping their worst. Commercial banks and investors financed by commercial banks bought many of these assets at fire-sale prices, transferring even more of the S&L's wealth to the banks.

From its August 1989 inception through February 1993, according to Bentsen's Senate testimony, the Resolution Trust Corp. had seized 737 S&Ls, closing 654 of them and placing another 83 in conservatorship, where they remain open under government control. During that period, the RTC seized $438 billion of assets and sold or collected $337 billion.

That's more than twice the size of Citicorp in seized assets, and more than BankAmerica and Chemical Banking combined, in sold or collected assets.

The remaining $101 billion, Bentsen said, "consists substantially of the hardest-to-sell land and real property, and non-performing mortgages."

Thus far, the government has spent more than $275 billion, before interest, on the S&L component of the bank bailout, and that figure will exceed $320 billion if the additional $45 billion is obtained.

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