Banking by Kathy Burdman

The free-market final solution

The Treasury and Fed go ahead with deregulation that they are well aware will mean the demise of thousands of S&Ls.

Several left-wing social democrats in Washington charged at the end of February that the administration's current support for Fed Chairman Paul Volcker and little else will cause shutdowns of whole sections of the U.S. banking system this year if continued. And the administration agreed.

In emergency legislation submitted to Congress Feb. 23 to aid the homebuilding industry, Rep. Fernand St. Germain (D-R.I.) urged the immediate establishment of a $7.5 billion Treasury fund to inject cash into the nation's ailing savings and loan sector. St Germain, the House Banking Committee Chairman, said the Reagan administration's policy is currently to "allow the S&Ls to be plowed under" by high interest rates.

This is true enough, since Fed Chairman Paul Volcker's tight money is forcing the S&Ls to pay an average 16 percent for deposits, while they only earn an average 8 percent on mortgages.

The same day, the Fabian Brookings Institution in Washington issued a major study of the S&L sector, predicting failure or death by merger of more than 1,000 S&Ls by the end of 1983. Brookings fellow Andrew S. Carron charged that the combination of high interest rates and deregulation will cost the government $8 billion to bail out the dying S&Ls' deposits.

I hate to agree with a social democrat, especially when he's just complaining about our President, but the Fabians *inside* the administration are acting as charged.

"Brookings is right, you know—but we think we can accomplish it for a lot less than $8 billion," a top source at Donald Regan's Treasury Department told me the same day. "St. Germain is also right. He just doesn't like what we are doing, because he has a lot of heat from his constituencies, and he wants to preserve the existence of S&Ls for home lending.

"Yes, interest rates will remain high, and yes the administration—at least this Treasury—will take no interventionist steps to bail out the S&Ls, except to continue our deregulation program, which will only accelerate matters.

"Why should we act? We want to shake down the [S&L] industry first. Let the free market do it. I'd say reducing the number of S&Ls by 25 percent, say a thousand or so, is about right." As he described it, Treasury and the Federal Home Loan Bank Board (FHLBB), are working with Volcker to apply a kind of free-market euthanasia to the S&Ls, "to save money and let the market do it."

The plan has several levels. First, Treasury is supporting Fed Chairman Volcker's recent announcement that the Fed will now act by fiat, without Congress, to declare protective banking regulations void, and allow cartelization of the banking system. Volcker is planning soon to permit big commercial banks, such as David Rockefeller's Chase Manhattan, to move across industry lines and buy up ailing S&Ls. The move will also be across state lines, allowing the big commercials not only to take over S&Ls home lending, but to do so rationally.

Second, the FHLBB's Federal S&L Deposit Insurance Corporation has announced it is cutting back on insurance pay-outs to S&Ls to save cold cash. The FSLIC, whose kitty is a mere $6.8 billion, has already laid out over $1 billion in mergers in 1981, paying off the buyer S&L to take the bad loans of the weaker S&L which it buys.

Now, my source says, the FSLIC is just going to "let the walking wounded walk." That is, the authorities will stop declaring certain selected S&Ls bankrupt—and let them go on doing business as if they were liquid, and buy up lower-tier "dying wounded."

"Solvency is in the mind of the public," the Treasury official observed. "As long as the public believes deposits are insured by the government, the S&Ls can operate deep in the red."

Third, and even wilder, is the Bank Board's new "purchase accounting" accounting fraud. Under this, an S&L in the red which buys another bankrupt S&L, gets an accounting break during the first five years, allowing it to actually make money on the transaction! The assets puchased, my source explained with a giggle, are brought into earnings twice as fast as the losses are written off. This can yield up to 20 cents on the dollar profit on the bad assets bought.

"It costs us nothing," my source said of the scam.