Paul Volcker puts S&L crisis at center stage

by Chris White

Cut the budget deficit, but spend what you have to, "without respect" for the budget deficit, to deal with the crisis in the savings and loan institutions. That was the two-faced message laid before the Robert Strauss-Drew Lewis co-chaired National Economic Commission during its latest round of hearings Nov. 30.

As usual, Volcker's cigar-chewing did not pacify the bluntness with which he addressed what other of the commission's witnesses have left unsaid. He did follow what has become the party line, calling for $30 billion in cuts from the budget, saying, "If you can do it, without tax increases, God bless you," and he did recommend his preference for a 9¢ on the gallon gasoline tax. His more dramatic intervention, however, was left for the case of the insolvent thrifts. He told the commissioners, according to the *Wall Street Journal's* account, "the U.S. shouldn't allow its concern with budget deficits to prevent it from spending whatever it takes to rein in runaway thrift industry insolvencies."

Volcker's testimony was paralleled by press conference remarks of William Seidman, chairman of the Federal Deposit Insurance Corporation, speaking at the National Press Club on the same day. Seidman demanded that the FSLIC be removed from oversight of the Federal Home Loan Bank Board, that $30 billion be provided immediately to shut down insolvent S&Ls, and warned, "A deposit insurance system out of control has the potential to melt down and damage the entire U.S. economy."

The concerns about what might be called "the integrity of the savings and loan system" are well taken. The prescription, that another $100 billion of taxpayers' money be poured down the sink is ridiculous. Its merit lies simply in the reality that those who call for $30 billion and upwards in cuts from the budget, are now going to have to face the reality that, however they choose to label the action, the budget deficit is going to be increased by more than the $70 billion that remains after the $30 billion in cuts are subtracted from the $100 billion starting point for dealing with the S&Ls. If this crude exercise tells some people that the deficit is now going to increase more than twice as fast as it is reduced, then perhaps lessons can learned, and the whole insane approach junked for something that will actually work.

As is well known, there is an insovlency crisis with the thrifts. That crisis, however, is not what it is usually ascribed to be. There are two features to it. One admittedly much larger than the other, both deadly, and neither can be dealt with by the kind of measures proposed.

Of equal concern, the Nov. 28 increase in the prime rate to 10.5%, rammed through by the money center banks under the leadership of Rockefeller's Chase Manhattan, as part of the international central bankers' efforts to break the will of the incoming administration, threatens to set off the chain reaction which will detonate both.

The two features are: first, thanks to Volcker's changes made while he was in office, the S&Ls, under his high interest rate usury regime, were forced into dependence on money market funds, borrowed to cover the shortfall in payments against mortgages outstanding. Now, of the $800 billion or so in thrift deposits, a sizeable portion is made up of "parked" certificates of deposit, funds borrowed from Merrill Lynch and other money center outfits, which, when under the FSLIC's $100,000 limit, qualify for insurance protection, just as real savers' deposits do. These funds generally find their way to where the interest return is highest. Therefore, they are a proportionally greater part of the deposits of the insolvent thrifts, which pay higher rates, to attract just such deposits. Thus the insolvent FSLIC is no longer simply insuring savings deposits of households and individuals, it also, in effect, has been put behind a chunk of the off-balance-sheet liabilities of the banking system as a whole, imparting the implicit full faith and credit guarantee of the U.S.

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government thereto.

That's part of what Seidman called "the potential to melt down and damage the entire U.S. economy."

The other part is more devastating, because it threatens not only the banking and investment houses, but also the credit of the U.S. government. Under the Reagan administration, quasi-governmental agencies, such as FNMA and GNMA, have been used to securitize a major share of outstanding mortgage debt. Growing from a level $200 billion of such transactions in 1982 to about $900 billion by now, these securitized obligations carry the implicit full faith and credit backing of Uncle Sam. This, too, is part of Volcker's destructive legacy. Unsecured obligations were bought from the thrifts by the quasi-governmental outfits, repackaged, and sold as instruments secured against Uncle Sam's good faith and credit. In this way, bad assets were transformed into good liabilities, by a touch of a magical wand.

Beyond the deposits covered by insurance, the government is also expected to stand behind the mortgage instruments it has securitized for resale.

In part done to maintain artificially high valuations for real estate, the secured debt of these government agencies is the real bomb ticking away. What happens, in the course of the developing thrift crisis, if some $200 billion of secured paper are presented back to the government for redemption? Does the government walk away from the obligation, print paper to cover it, or what? Hypothetical that case might be. Under the urgency now communicated by Volcker and company, the plain fact is that the thrift crisis, on its own, can pull down the foundations of the entire usury system, and blow out the credit of the U.S. government itself.

Also, the plain fact is that as part of the $15-20 trillion debt bubble of the dollar credit system, which was punctured between August and October of last year, and threatened to explode Oct. 19, 1988, this is going to come down anyway. Some deceive themselves that they were controlling, or managing, the process over the last year, to the effect of preventing another blowout before the elections. What they were actually doing was aggravating the swollen pile of indebtedness which is the driver of the collapse process, thanks to their own obsessive stupidity and insanity. Exemplary is what the man who made himself chief instrument of the aggravation, James Baker, permitted poor Danny Wall to do with the Federal Home Loan Bank Board. It is estimated by insiders that for the $30 billion Wall has put into the thrifts in the form of FSLIC notes, he has added 10 times that in the form of government obligations, as part of the process called "keeping the system under control."

On this, the technical managers argue, as they do on the approximately $900 billion of U.S. faith-and-credit-secured mortgage obligations, that since such guarantees will never be called, it's not a real obligation, so it doesn't have to be counted.

That brings us back to the latest round of interest rate increases. The managers look at this collapsing system under two aspects: the external obligations of the United States, reflected in the momentary exchange rate valuation of the dollar, and the internal credit structure of the country. They endeavor to maintain the interrelationship between the two, using crisis management methods in manipulating the dollar to force internal adjustments in credit and fiscal policy to safeguard the income stream for foreign creditors. Thus, the latest round of interest rate increases is the trade-off for central bank forbearance in dollar support agreed on by the Big Four of the Group of Seven—the United States, Japan, France, and Germany—at secret meetings in Paris on Nov. 14. Their game is to threaten the dollar to force a tightening, and further savage austerity inside the United States, and then another round against the dollar for another round of tightening and austerity.

Worse to come

As with Baker's so-called "stability" policy last year, this type of central bank-enforced "crisis management" effort will make things worse; it will also more than likely detonate the bombs that Baker and company built into the basement of the edifice of debt they attempted to shore up over the last year.

So now we hear the experts: "Bush is not going to know what hit him. . . . George Bush is going to have a financial crisis in his first six months as President and it's going to be a doozie. . . . We're a debtor nation now and there are other people calling the shots. . . . That's the reality. . . . The fact of life is out there in those foreign exchange markets, and they have changed in attitude." That was Wall Street economist David M. Jones on ABC's "Good Morning America" with Charles Gibson, on Nov. 29.

Just bear in mind that neither the ones who are pushing for the crisis, nor the ones who claim they are out there maintaining stability, actually know what they are doing, let alone what has already been unleashed. Nor do any of them as yet give any indication that they might be prepared to take the trouble to find out what it is they should be doing.

So now, they lay before us the further prospect of interest rate increases, next the Fed's discount rate, by the end of December another increase in the prime rate, as it heads back toward 13%. All this, that the Group of Seven might conclude the outline of another dollar stability pact on Jan. 20, or thereabouts.

And, meanwhile, by doing this, they are surely setting into motion the collapse of another $7-10 trillion worth of bloated paper. And with their insane obstinacy they are helping to dismantle the means available to turn the whole thing around. The core of the S&Ls' functions, as depository and mortgage lending institutions, is a vital conveyor belt for feeding credit into actual economic recovery policies around the country. Without the S&Ls, that won't happen, but that is what these demented systems managers are walking the rest of us into. Just as the captain of the Titanic took his ill-fated vessel into the icefield to ensure that he arrived in New York on time.