Banking by John Hoefle

The S&L bailout needs a bailout

With a commercial bank bailout looming, the thrift crisis is still unresolved and demanding greater funding.

When the Bush administration unveiled its S&L "bailout" bill, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), in August 1989, it promised that the entire $1.2 trillion in assets in the thrift system could be saved at a cost of $50 billion over the first three years and $166 billion over 10 years.

EIR warned at the time that the cost of the bailout was vastly understated. It would get much worse, we warned, because nothing was being done to deal with the economic collapse which was destroying the financial system.

By the end of September, with the ink barely dry on FIRREA, William Seidman, the chairman of the newly created Resolution Trust Corp., told Congress that the RTC would need an additional $50-100 billion in capital to close sick thrifts. These additional funds were needed as "working capital," Seidman said, claiming that the funds would be repaid when the properties seized by the RTC were sold.

In early January 1990, the RTC released its self-styled "strategic plan" to sell the assets from 283 seized thrifts, and use the proceeds to seize more. "It is important that the RTC proceed and continue to actively dispose of assets immediately," the RTC Oversight Board announced. "The RTC should avoid deferring the marketing of properties. Holding properties off the market for an extended period of time may increase the ultimate cost of asset disposition." How the RTC was supposed to rapidly sell 30,000 properties without exploding an already-collapsing real estate market was not explained.

Meanwhile, S&Ls were failing at record rates, with 229 failures in 1988 and 328 in 1989.

By Jan. 7, Seidman announced that the RTC was out of funds, and could close no more thrifts unless the demanded working capital was produced. "It's clear that the bailout operation is quickly becoming unraveled," observed James Barth, a former chief economist for the Federal Home Loan Bank Board.

With thrifts failing much faster than the RTC could handle, the agency announced an abrupt policy change on Jan. 31. Whereas the government had previously insisted that it was essential that insolvent thrifts be closed as quickly as possible to keep expenses to a minimum, the RTC suddenly said that it was too expensive to close insolvent thrifts. It's cheaper, he claimed, to leave them open. It was a de facto admission that, after only six months, the great Bush thrift bailout was a failure.

By mid-February, RTC Oversight Board president Daniel Kearney had resigned in disgust. Simultaneously, the administration announced a plan to let the RTC borrow working capital from the Federal Financing Bank, a Treasury Department agency, to augment FIRREA-prescribed bond offerings.

To cover up for the failure of their bailout scheme, the Bush administration launched a propaganda barrage aimed at painting the operators of failed thrifts as crooks. Seidman claimed that federal investigators had found fraud at 60% of the thrifts seized by the government. A later study by consultant Bert Ely would reveal that fraud accounted for only 3% of the losses at failed thrifts.

The RTC continued to amass assets from failed thrifts, becoming the largest operator of financial institutions in the country.

In March 1990, the RTC launched "Operation Clean Sweep," a program to sell or close 140 institutions by the end of June. "Losses can only be stemmed by the swift sale of all property to private sector buyers," Seidman said. Like the earlier "strategic plan" sale, Operation Clean Sweep was a dismal failure. By May, the RTC was forced to begin slashing prices to sell its holdings, and even announced a nationwide television auction. The auction was later canceled due to lack of interest. So far, the RTC has sold only about 25% of the $120 billion in assets it obtained from the first 352 thrifts.

The pattern has changed little in the year and a half since the passage of FIRREA. The administration has been forced repeatedly to return to Congress to ask for more funds. So far, the administration has spent $121 billion, and is requesting another $78 billion for fiscal year 1991. If approved, that would make $199 billion in two and a half years, more than four times the administration's three-year estimate and nearly 20% higher than the 10-year projection. The General Accounting Office has warned that the ultimate cost of the thrift bailout may go as high as $500 billion, including the interest that must be paid on the borrowed funds.

As House Banking Committee chairman Rep. Henry Gonzalez (D-Tex.) observed last month, "I'm fully convinced the RTC has lost control of the situation."