FSLIC rescue plan sinks

Depositors and savers will be left holding the bag, as the government underwrites the most bankrupt sectors.

The much-touted congressionally approved, administration-backed rescue of the bankrupt Federal Savings and Loans Insurance Corporation (FSLIC) was launched during the first week of October, when the financing corporation, established by law to borrow to replenish the insurance fund accounts, floated its first 30-year bonds.

The good news, for some, was that the bonds were marketed successfully. The bad news was that the thrift system's losses continued to grow in the second quarter. The net loss of $1.6 billion for that three-month period is almost as much as the FSLIC has been empowered to borrow for the whole year.

Thus the rescue plan, part of a political package designed to try to keep the crumbling financial system together through the elections in 1988, sank before it even left the wharf.

The plan gave the thrift system a credit line of about $750 million with the Treasury, and empowered the Federal Home Loan Banks to raise about $2 billion a year for the next four years, by borrowing on the financial markets and hocking their memberships' assets as collateral on the loans. Implicitly the arrangement is backed by the faith and credit of the U.S. government. Though it is stated in the act authorizing the arrangement, that the Financial Corporation, under which the Home Loan Banks can borrow funds, is not an agency of the U.S. government, it is nonetheless assumed by those who are encouraging the borrowing spree, that the government will stand behind the indebtedness incurred.

This has hair-raising implications: It means that the U.S. government is guaranteeing the right of the creditors of the thrift system to take over the remaining assets of the system as a whole. What will be left for the depositors and savers, as their banks are stripped clean, is by no means clear, but won't be too much.

This is evident from the simple discrepancy between the magnitude of the FSLIC loss problem, and how much Congress and the administration are prepared to finance that loss.

Even the governors of the Federal Reserve System now warn that the thrift system's losses are much greater than anything Congress or the administration have publicly taken into account. The figure bandied around by the Fed is in the range of $40 billion, about five times greater than the Congress and administration agreed to provide over the next few years.

However, the Federal Reserve estimates that the $40 billion would be required now to liquidate the more than 500 member-institutions of the thrift system which are *already insolvent*. The Fed's estimate is shared with thrift system insiders and others.

Thus, as we have warned before, the "rescue plan" is nothing of the sort. It is too little, and too late, to stem the collapse of the system. Therefore, it isn't intended to. Mortgage debt, backed by the earnings of Americans, accounts for about one-third of the debt outstanding in the economy. The debt is of a different quality than other instruments held by financial institutions, since it is backed by the earnings of households. As long as the earnings last, the debt will be honored. The same cannot be said of many of the other types of instruments held by the banks and their financier friends.

Of the total mortgages issued in 1986, the thrift system issued 40%. This means that fundamentally, the thrift system, because of the earnings of its depositors, and because of the collateral against its loans outstanding, say 40% of the mortgage market, is in much better shape than any other sector of the financial system: a dependable income stream set against a long-term asset-building capability.

The thrifts were wrecked by former Federal Reserve chairman Paul Volcker's high interest rate policy of the early 1980s, as the cost of borrowing new money rose above the interest payments on earlier mortgages. The system was financially bankrupted, as it was encouraged to play the margins on international financial markets, to cover the difference.

Now, it looks as if the so-called rescue package is simply a scheme to have the U.S. government back the transfer of the relatively healthiest parts of the financial system to the most corrupt and bankrupt part. The lenders to FSLIC will get a first lien; depositors and savers have been set up to be swindled.

The Fed brought up the actual magnitude of the FSLIC crisis, to justify the reorganization of the banking system. That reorganization would rip off depositors and savers, in favor of concentrating financial power in a mere handful of super-banks. It should be stopped, by reorganizing the financial system to protect the relatively healthier and stronger, not by feeding the cancer which threatens to destroy everything.