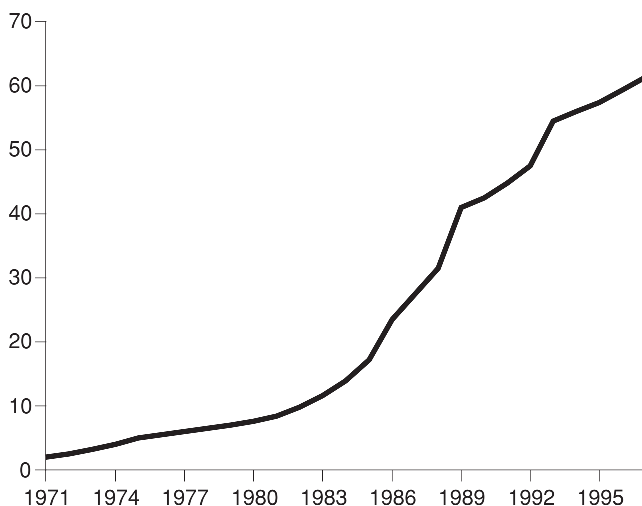
FIGURE 3
Japanese commercial bank lending to real estate, 1971-97
(trillion yen)



Source: Bank of Japan.

plan was only one component of a total bailout package; to implement such a package in Japan today, would touch off a hyperinflationary explosion, as shown by the following points:

1. Japan has already put its banks on life-support for the last four years, with the central bank, the Bank of Japan, having lowered its discount rate to 0.35%. This has not saved the banks; instead, the money has flowed into speculative markets around the world. This cannot be thrown in as a new gimmick: It has already been tried.

2. Japan cannot add derivatives as a new element, as the United States did in 1987-93, since Japanese commercial banks are already staggering under $12 trillion in derivatives. Unless Japan wants to triple its level of derivatives, a disastrous thing to do, it won't get the "kick start" that it would hope to obtain from derivatives.

3. Japan's real estate portfolio is immense. While no figure is available for the total valuation of all Japanese real estate, its commercial bank lending to real estate has risen from 2.5 trillion yen in 1971, to 7.6 trillion yen in 1980, to 61 trillion yen in 1997, an eightfold increase since 1980 (see **Figure 3**). Beyond rational planning, Japanese banks continued to lend to real estate.

Furthermore, a study by Fitch/IBCA bank analysts reports that the value of commercial real estate in Japan, principally in Tokyo and Osaka, *is 70% below where it was in 1990*. It will not be simply a matter of waiting six months, or 1-2 years, to have the Japanese real estate market "turn up" and sell off the impaired assets. In the midst of the advancing world financial disintegration, a separately organized Japanese real estate price turnaround is not going to occur.

4. Japan's non-performing loans are even larger than those the United States had. German banks, operating in Tokyo, put the figure of Japanese commercial bank non-performing loans at $1.5 trillion.

5. Above all, the Japanese banking system is part of the world banking system and world derivatives bubble. It cannot be "saved" as an independent operation, but bailing it out would require a bailout of the world derivatives bubble—an impossible undertaking, with fatal consequences if it were attempted.

Japan has got to face reality: Writing off its bad financial paper, in the context of a New Bretton Woods monetary system, as proposed by LaRouche, is the only strategy that has a chance for success.

U.S. RTC destroyed the real economy

by Kathy Wolfe and John Hoefle

Tokyo's July 2 announcement that it will deal with Japan's $1.5 trillion in bad bank debt using a "bridge bank," on the model of the 1989-95 U.S. Resolution Trust Corp., is a prescription for disaster, just as the RTC was in the United States.

Starting in March 1981, *EIR* warned that the 1980-82 U.S. bank deregulation laws would bankrupt the savings and loan institutions, which had assets at the time totalling $800 billion; this promptly occurred. Runs on S&Ls began in 1985; from 1987-90, the S&Ls had net losses of over $20 billion.

Contrary to Wall Street's mythology, the "RTC process" did not save either the U.S. financial system or the S&Ls. Instead, it moved billions of dollars in consumer deposits out of S&Ls in local communities, and into Citibank, Merrill Lynch, and other large Wall Street banks and brokerages. It also slashed the *physical economy* financed by the S&Ls, the homebuilding industry, which once made the homes of the "American dream" the envy of the world.

Explaining his call for bank deregulation, Citibank Chairman Walter Wriston told *Forbes* magazine in September 1982, that Wall Street planned to grab S&L and related deposits. "Willie Sutton said he robbed banks because that's where the money is," Wriston laughed. "I see $1.2 trillion in consumer deposits out there, and I don't see a number like that anywhere else."

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FIGURE 1
Net income of U.S. thrifts
(millions $)

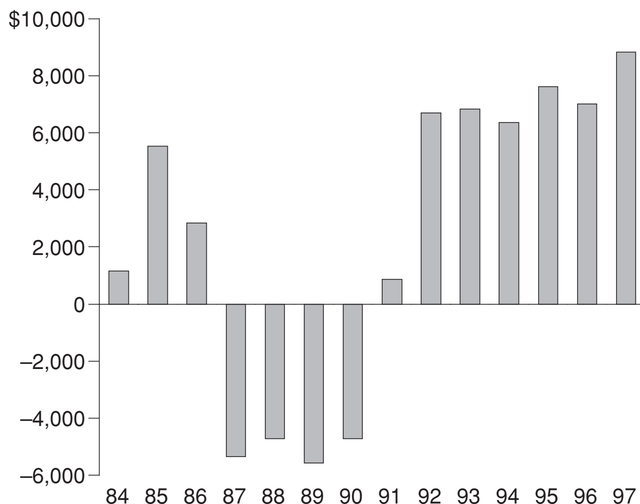
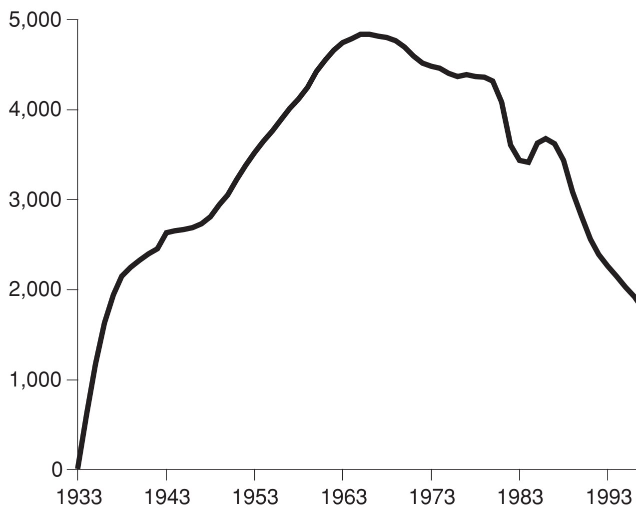


FIGURE 2
Number of U.S. thrifts



Today, London Euromarket banks and their Wall Street nephews see another "number like that" to grab: the $12 trillion in private savings in Japan. They also want to put a dent in the physical economy of Japan and other Asian nations, which the giant Japanese banks have financed, and which British and Wall Street bankers have resented for decades. The "bridge bank" idea is more like a short pier. Certain British elites would like Japan to take a long walk off the end, and disappear into the Pacific Ocean.

The grab has already begun. In May and June of this year, Japanese citizens moved $6.6 billion worth of private yen savings into speculative foreign mutual funds run by Citibank, Merrill Lynch, etc., Japan's Investment Trust Association announced on July 12. Some $3 trillion of Japanese savings will flee abroad after more deregulation in December, Princeton Economics chief Martin Armstrong predicted on June 22.

RTC: 'Let them die'

The RTC's "success story" is that the S&Ls and other "thrift" savings banks left standing in the United States today report record profits: $7.6 billion in 1995, $7 billion in 1996, and $8.8 billion in 1997. The story goes that the thrifts were taken over during 1981-88 by crooks who lost billions, but the RTC, founded in 1989 as a "bridge bank" inside the U.S. Treasury Department, stopped the crooks, took over the bad old S&Ls, sold off their bad real estate loans, created a few good new S&Ls, and restored bank soundness (**Figure 1**).

The story is a fraud. The RTC and the 1980-88 deregulation laws were coordinated parts of a single banking plan written in 1979-81 at the Federal Reserve and Treasury. It was a spin-off of the Carter State Department program *Global 2000,* the blueprint to reduce world population to 2 billion people between 1980 and 2000. The authors were Fed Chairman Paul Volcker, who had called for "controlled disintegration" of the world economy, and Treasury Secretary Donald Regan, former chairman of Merrill Lynch. There, he had worked closely with Walter Wriston to lobby Congress for banking deregulation.

The main purpose of the plan was to *bankrupt* the S&Ls and other thrifts, then use the RTC to *reduce their number by half,* from over 4,000 in 1980, to under 2,000 by 1996 (**Figure 2**). The people who created this bankruptcy said plainly that their goal was to *reduce the S&Ls' lending for homes*.

S&Ls and other thrifts were created by President Franklin Roosevelt in 1933 to help build America out of the Depression. They were "dedicated lenders," mandated by law to make 85% of their loans for home-building mortgages. The law encouraged thrifts to be set up in every town to build houses, by giving them legal privileges to pay citizens more than banks paid for savings deposits. From 1933 to 1980, while other banks were limited by the law known as Regulation Q (Reg Q) to pay only 5% for deposits, S&Ls and other thrifts were allowed to pay 6%. By 1980, the thrifts had $674 billion in deposits, and almost $500 billion in home mortgages outstanding.

But after the 1970s oil shocks and Volcker's 1979 20%-plus interest rate shock, the Global 2000 group announced that there would now be "limits to growth." They complained that widespread home-ownership had encouraged population growth in America. The S&Ls would have to go, the Fed and Treasury decided.

"Don Regan and [Budget Director] Dave Stockman intend to let the S&Ls die," a Regan Treasury official said (*EIR,* March 24, 1981, p. 13). "We've allocated too much capital to housing. Now, we have scarce resources. The typical American wants to live in a three-bedroom house. That's asinine. He'll have to take a smaller, energy-efficient apartment. . . . Fewer homes mean Americans will have fewer children. Less space in apartments means smaller families. That's a good policy."

'Market forces'

Shortly before this statement, in March 1980, Volcker's Global 2000 crew had Congress pass the "Depository Institutions Deregulation and Monetary Control Act," which began to phase out Reg Q and the mandate that S&Ls be "dedicated lenders" for housing. It also began the phase-out of bank and S&L reserve requirements and other safety laws.

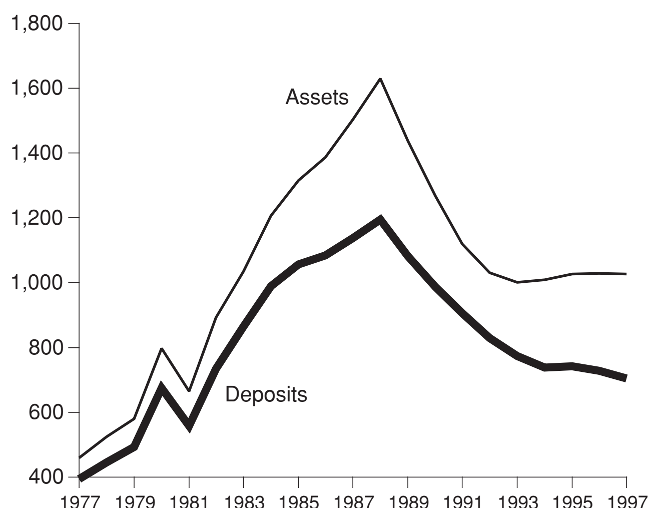
By April 1980, Fed Chairman Volcker had hiked interest rates from 6% to 20%. Commercial banks and money-market funds at Merrill Lynch moved to double-digit rates as Reg Q was phased out. Depositors began a run against the S&Ls and other thrifts, moving deposits into high-interest bank and broker accounts.

S&L profits fell 75% during 1980, and the thrifts were hemorrhaging deposits, which fell by $117 billion during 1981, the first such drop since World War II. More than 400 S&LS were rumored to be technically bankrupt. Desperate S&Ls began to offer double-digit deposit rates like the Wall Street banks, but they could do nothing about the almost $500 billion in home mortgages which constituted 85% of their assets. Those loans had already been made, and the return on them was fixed for the 20- to 40-year life of the mortgages, at 7-8%. No S&L could pay 10% or more to depositors, while only earning 7% on mortgages, and keep its doors open.

But didn't Volcker and the other "experts" know the S&Ls were locked into those 7% mortgages when they raised deposit rates to over 10%? Sure they did. It was a matter of deliberate policy. On April 28, 1981, Treasury Secretary Regan insisted that the drain on the S&Ls be allowed to continue. He told a worried Senate Banking Committee that the situation "does not warrant" any action. "We must place greater reliance on market forces to determine the structure of our financial system," he said.

"But I never got a home mortgage from Merrill Lynch," Committee Chairman Sen. Jake Garn (R-Utah) pointed out. "Not yet," said Regan (see *EIR,* May 19, 1981, p. 9).

FIGURE 3
Assets and deposits of U.S. thrifts
(billions $)



That is, while *EIR* alone was warning about the pending doom of the S&Ls, Volcker and Regan encouraged it. On Oct. 15, 1982, Regan personally forced into law the "Depository Institutions Act of 1982," which removed Reg Q and dedicated lender mandates, and permitted Citibank and Merrill Lynch to buy S&Ls. They did so, quickly.

"Don Regan wanted to see the demise of the thrift industry," then-Federal Home Loan Bank Chairman Edwin Gray later told *EIR* in an interview about this 1980-87 period. Regan "blocked my every effort to brief the Cabinet" on the S&L crisis, he said (*EIR,* Feb. 10, 1989, p. 6).

Desperate for cash to pay 10-13% deposit rates, thrifts bought into high-yield junk bond and real estate speculation, sold to them by pirates like Michael Milken and Ivan Boesky. That is, after 1982, the S&Ls could only pay depositors by making speculative loans and investing in junk, such that total thrift assets mushroomed past $1.5 trillion (**Figure 3**).

In 1985, the S&L systems of Ohio, and then Maryland, suffered deposit runs and collapsed. By the end of 1986, when the junk bond market blew, many thrifts were losing millions. The thrifts' 1987 losses were $5.3 billion, and that was only the beginning, as Figure 1 shows.

More than 50 thrifts failed in 1986 and 1987 each; 222 thrifts with over $110 billion in assets failed in 1988.

Bubble, crash, buyout

The damage was done, and Regan and Volcker laughed all the way back to their new million-dollar jobs in the private

sector. The public grew hysterical, as many lost their savings, and on Aug. 9, 1989, the RTC was formed, when President George Bush signed the Financial Institutions Reform, Recovery, and Enforcement Act.

The RTC operation was a textbook case of the method used by the financiers of old Venice to take over a competitor's market: Bubble it up, crash it down, and buy it out at a fraction of its original value. In the 17th-century "Tulip Bubble," Venetian funds whipped up the public to buy tulip bulbs and futures until prices were insanely high; then the Venetians dumped shares, creating a panic in which the Dutch market crashed. The Venetians then bought up the Dutch state debt and Dutch banks for a song, and founded the Bank of Amsterdam, Holland's central bank, as their private bank to manage the state debt.

After William of Orange imposed Dutch rule on England in 1688, Venetian and Dutch banks repeated the same "bubble, crash, buyout" program. They bought up the English state debt, and created their private Bank of England to manage it. Operating from London, these same families used this proven method to take over the New York financial market in the 19th century.

The 1980s S&L crisis proceeded in just this way: Banking was deregulated, to bubble up S&L assets, deposits, and interest rates to insane values (1979-87), with the inevitable crash (1988). The RTC's job was to manage the buyout, at 10¢ on the dollar (1989-95).

In 1989, the RTC took over 281 S&Ls and other thrifts, with deposits totalling $101 billion and assets of $132 billion, and began to sell them at deep discount. Ready to enjoy the buyout were Citibank, Merrill Lynch, and a host of Wall Street vultures. At first, the RTC attempted "whole bank transfers," in which it tried to sell an S&L it had seized, both deposits and assets in one batch, to the big commercial banks and large S&Ls at deep discounts. Citibank and others snatched up several during this period and cheaply created chains in states such as Maryland, where S&Ls had suffered bank runs.

By 1991, the RTC had seized 611 S&Ls, with deposits totalling $252 billion and assets totalling $335 billion. Now, however, so many S&Ls were going under, and the U.S. real estate market was so depressed as a result, that the vultures refused to buy whole S&Ls. They demanded to "cherry pick" only the best pieces of flesh.

The RTC was forced, after taking over an S&L, to separate its deposits and its assets. The deposits—the cookie which Walter Wriston set out to grab—would be "bought" by a commercial bank or a larger thrift bank. The premiums paid by the commercial banks to the RTC were so small, on grounds that the deposits were "liabilities," that *these deposits were virtually given away*.

In the end, deposits in the S&L system fell by a total of $500 billion, from $1,200 billion to under $700 billion (Figure 3). Those deposits, and billions more that might have been put into safe, insured S&L savings under Reg Q, have gone instead into uninsured speculative money-market funds at Merrill Lynch, Citibank, and so on. American citizens now have their savings invested, instead, in the greatest tulip bubble ever known: the stock market.

Next, the RTC would have to unbundle an S&L's mortgages, loans, and other assets, and sell them at deeper and deeper discounts. The RTC set up dozens of offices all over the United States, auctioning homes and other real estate at 20-50¢ on the dollar. Mortgages and mortgage-backed securities from the S&Ls worth some $400 billion, were handed to big-money players for a fraction of that sum.

From 1989 to 1995, the RTC seized and sold 747 S&Ls and other thrifts, whose deposits totalled $315 billion and assets totalled $416 billion, in this discount dumping. *The process so depressed the entire U.S. real estate market for a short period of time, that vultures like speculator George Soros picked up many large blocks of real estate at rock-bottom prices*.

Economic consequences

The experience of the S&Ls was remarkably similar to that suffered by Asian nations after speculators destroyed their currencies in 1997. In February 1997, Korea's Hanbo Steel Co. was worth 3,500 billion Korean won; at 700 won

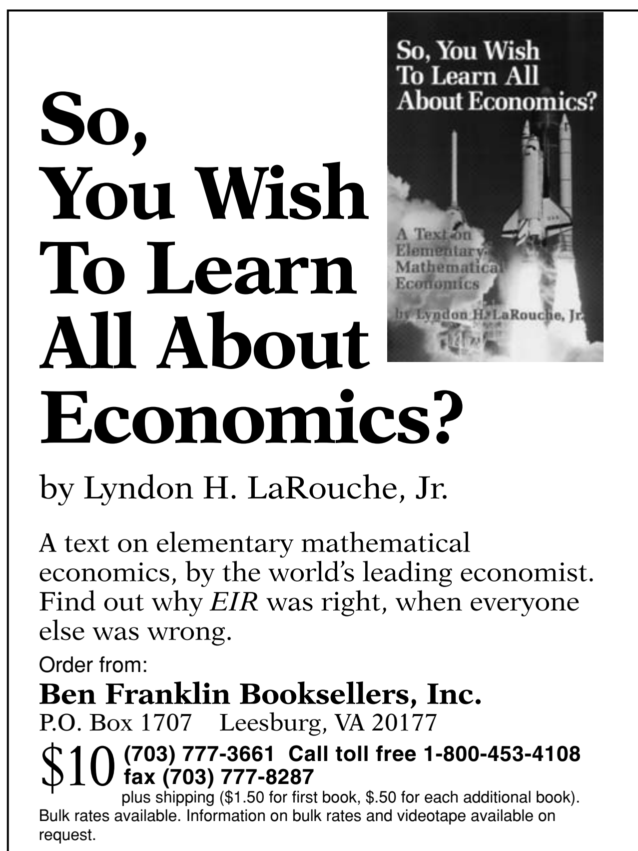
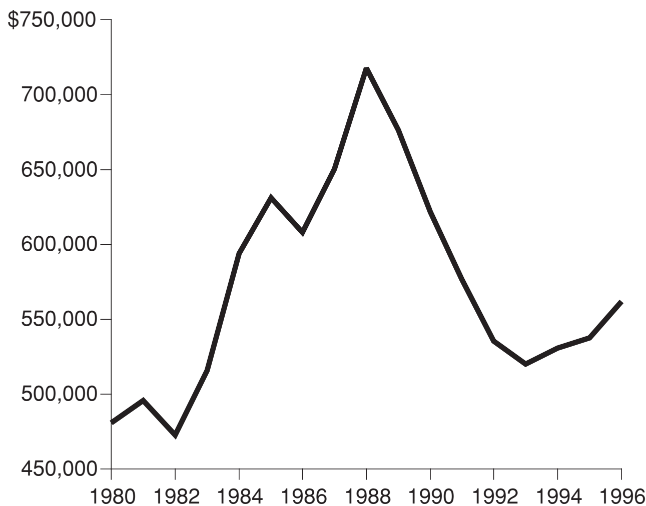


FIGURE 4
Market value of home mortgages held by U.S. thrifts
(millions $)



per U.S. dollar, that's $5 billion. After Soros bashed the won down to 1,600 won per dollar, the same set of steel mills called Hanbo could be bought by foreigners for $2 billion.

The RTC brags that, while it borrowed over $250 billion on capital markets during 1989-95, it made enough money by the sale of S&L assets to pay back all but $85 billion, which the RTC claims is the net loss to U.S. taxpayers. Add $71 billion lost during 1985-89 by the Federal Savings and Loans Insurance Corp., which paid off depositors of bankrupt S&Ls before the RTC existed, and the total *official* cost of the S&L bailout is $156 billion.

The damage to the economy by the wholesale transfer of ownership of assets to speculators, however, far outweighs this figure.

Just look at what happened to housing. Even the nominal paper market value of home mortgages issued by the shrinking S&L sector, which used to be the "dedicated lender" to housing, shrank dramatically (**Figure 4**).

In 1978, before Volcker jacked up interest rates, America produced 0.029 construction units of housing (measured as housing starts) per family household per year. By 1996, this had fallen to 0.013 housing units per family, *less than half* the 1978 output. In 1978, there were more than 2 million new single-family and multi-family housing units built in America. By 1990, this number had fallen to 1.2 million, also almost a 50% drop.

Behind the dollar figures in Figure 4, which are not adjusted for inflation, we can show the same 50% collapse of housing. The median cost of a new home in the United States in 1980 was $70,000. During the crisis, this price more than doubled, to $120,000 in 1990 and $140,000 in 1996. In 1996, Figure 4 shows, thrifts held mortgages worth about $560 billion in dollar terms—but with a $140,000 mortgage in 1996, a family could only buy a house worth half as much, in 1980 terms.

This means that to compare the 1996 number of $560 billion in dollar mortgages in Figure 4 with the 1980 number, we'd need to slice the $560 billion in half, to $230 billion. In other words, the real-world value of mortgages financed by S&Ls plummetted from $475 billion in 1980, to $230 billion in 1996.

It gets worse: Factor in increased interest charges, thanks again to the deregulation of Reg Q, and the cost for the same house almost *tripled* between 1980 and 1996. If interest on the mortgage is included in the home price, the average new home price was $130,000 in 1980, but rose to about $350,000 by 1996.

Consequences in Japan

Is it acceptable to do this to the heavy industry and infrastructure of Japan and the rest of Asia, which depend on Japanese bank lending? If Japan's Long-Term Credit Bank goes under, for example, will it be acceptable to sell off the millions of dollars in loans it holds for Japan's famous bullet trains and nuclear power plants, to foreign speculators?

In any case, it is impossible to repeat the RTC excercise in Japan. For one thing, the Japanese problem is about three times as big. At the depth of the S&L crisis in 1988, the thrift system of America had $1.6 trillion in total assets (Figure 3). Of this, no more than 30% were bad ("non-performing") loans, totalling about $500 billion. Japan's private banks today have $5-6 trillion in total assets, and about $1-1.5 trillion in bad loans.

More important is to look at the "big picture" of what was happening meanwhile to the *world banking system as a whole* during 1980-95. As Richard Freeman shows in the preceding article, the RTC's actions were able to proceed due to a multi-trillion-dollar hyperinflation of the *rest* of the world banking system.

It included an inflationary bubble created in the assets of the U.S. commercial banks, which rose from $3 trillion in 1991 to $4.4 trillion today; the assets of the London Eurodollar banks, which rose from $3.5 trillion in 1991 to $5 trillion today; and the $5 trillion assets of the Japanese banks themselves. Not the least of these was action by the Bank of Japan, which has been printing money at 0.5% and giving it away to banks all over the world since 1994.

Japan's alternative is to demand an international conference to write down the *global* bad bank and stock paper on a cooperative basis. In this case, no nation's markets need suffer a run relative to any other's. Otherwise, Japan faces another 1930s scenario, and the world faces a crash beyond anyone's imagination.