Savings & loan crash becomes battleground for 1988

by David Goldman

The Reagan administration has set off a partisan-political battle over the $1.2 trillion savings sector, undermining what chance remains to postpone the crash of the thrift industry, as a prelude to a general banking panic. In its panic to manage the *political* consequences of the thrift crisis, the administration appears to have damaged its goal of postponing the outbreak of financial crisis until after the 1988 elections.

While Texas savings banks face a run by big depositors, U.S. Assistant Attorney General William Weld has launched the biggest-ever criminal investigation into fraud by savings bankers. Three hundred subpoenas have already been issued by a Dallas federal grand jury, to S&L executives, real-estate developers, and brokers who made deals with 100 Texas S&Ls. An FBI spokesman described it as "one of the largest S&L investigations in history."

Weld is not everyone's model of a squeaky-clean prosecutor. In 1984, after the Bank of Boston pleaded guilty to laundering $1.2 billion of Angiullo crime-family drug money, Weld, then U.S. Attorney for Boston, arranged a minimal $500,000 fine for a bank to which his family (of the White, Weld firm of Wall Street traders) had longstanding connections. Even after the fine and legal expenses, Bank of Boston walked away from the scandal with a substantial profit. The incident almost cost Weld his appointment as Assistant U.S. Attorney for the Criminal Division in 1986.

Regulatory officials familiar with the investigation are suspicious. They complain that attorneys for the Federal Home Loan Banks, which monitor S&Ls, had sent "the equivalent of cratefuls of smoking guns" to the Department of Justice for years, without response. "The understanding was that these are good, Republican political donors, and we should leave them alone. The Department of Justice just didn't want to prosecute these people. Our attorneys were appalled," complained one senior regulator. Attorney General Edwin Meese, as well as his predecessor William French Smith, has close ties to the California savings industry.

Meanwhile, the Democratic-controlled House oversight committee on Banking, chaired by Georgia's Rep. Doug Barnard, has leveled its guns at fraud in the California thrift industry, i.e., at the dead center of President Reagan's political base. Congressional sources close to the inquiry point out the California investigation was instigated by the state's Republican-appointed savings and loan commissioner, and deny any partisan intent. The net effect will not be much different.

Both the Justice Department and the banking subcommittee have agreed to a pernicious, and dangerous piece of sophistry: Since the pattern of fraud is provably widespread, then banking failures are principally due to banking misconduct, rather than economic conditions. The Federal Home Loan Bank Board staff takes the same view. "You've got S&Ls out there with a $500 million negative net worth, that never made a mortgage loan. How can you attribute their problems to interest rates?" asked one analyst.

The problem is, in an economy based largely on real-estate speculation, to differentiate between "legitimate" speculation and "illegitimate" insider dealings. The combination of the Reagan administration's 1981 tax code, and Paul Volcker's first round of banking deregulation, turned failing S&Ls into shells for real-estate speculation.

As of last fall, senior real-estate industry sources were predicting a 25-40% crash in prime commercial real-estate prices, including in such previous boom areas as downtown Manhattan. A January 1987 study by Brookings Institution real-estate economist Anthony Downs warned that the rate of office absorption would be slowed considerably from the 1985 rate of 5.8% of total inventory, because of the following factors: 1) the slowdown of labor force growth; 2) cutbacks in white-collar employment (e.g., the 25% cutback at General Motors); and 3) economic recession. Downs relates the collapse of the office market to the end of the service-industry boom: "The number of office workers employed grew 932,000 in 1983, 835,000 in 1984, and 767,000 in 1985—18% less than in 1983. Overall labor force growth averaged 2.4 million persons per year in the 1970s, but only 1.65 million annually from 1980 to 1984—down 31%."

Looked at another way, the boom in office-building and shopping-mall construction *created* the bottom-quality employment growth of the spurious "Reagan recovery." The collapse of the boom will take down the men of the "Reagan revolution," the get-rich-quick real estate operators who head the contributors lists of every Republican organization (and some Democratic ones) in major American cities. The collapse of the thrift industry represents, in fact, the dismal hangover after the "Reagan revolution," and it is big enough to trigger a global financial disaster.

Nonetheless, both sides are committed to lying about the nature of the problem, such that any action to cure the problem before it explodes cannot be foreseen under present political circumstances.

Wright's worry

A large part of the reason for House Speaker Jim Wright's (D-Tex.) reluctance to provide additional funds to the bankrupt Federal Savings and Loan Insurance Corporation, reportedly stems from fears that an official regulatory windup of the affairs of Texas S&Ls "might compromise the entire Texas congressional delegation," as campaign contributions are traced back to alleged bank fraud, according to knowledgeable sources. Of course, Wright has reason to be concerned for the effect of the shutdowns on the Texas economy as well. Hearings last March by Rep. John Dingell (D-Mich.) accused the FSLIC of closing troubled but potentially healthy S&Ls without proper cause. FSLIC takeovers, Wright and his colleagues point out, result in the dumping of S&Ls' real-estate holdings onto an already-depressed market, further collapsing real-estate prices.

Until April 28, Wright held out for a mere $5 billion recapitalization of FSLIC—the agency needs closer to $50 billion immediately—in order to prevent it from having to shut down regional institutions (the Dallas Federal Home Loan Bank alone says it needs $4 billion in immediate cash). He only reversed himself, and accepted the administration's still-inadequate figure of $15 billion, after writing language into the bill which prevents the closure of savings banks whose trouble stems from the economic depression, rather than fraud. When a House-Senate conference knocked the sum allocated to the FSLIC down to a token $7.5 billion, sources at the Federal Home Loan Bank Board complained that Wright had sabotaged the funding from behind the scenes.

The *Washington Post* complained in a June 13 editorial, "In a spectacularly dangerous example of misguided sympathy, Congress is hard at work on legislation to make S&L regulation weaker than ever. It has nothing to do with Reaganite enthusiasm for deregulation. The impetus is coming from Democrats and mainly from Texas. The House has passed a bill that would make it harder for an S&L to foreclose on delinquent loans, of which there are many in Texas, and very much harder for federal regulators to close an S&L that is insolvent. The chief regulator says that the bill, if enacted, 'will shut down effective enforcement.'. . . Out of the nearly 3,200 federally insured S&Ls, some 450 are now bankrupt but still in business and still taking deposits from the public. If they were banks, they would have been shut down long since. But the S&L regulators can't afford to close down these bankrupts because there isn't enough money in the federal S&L deposit insurance fund to pay off the depositors."

It should not surprise the editors of the Post that Wright and his friends refuse to come along quietly; this is a matter of life and death not only for the regional economy, and their friends, but perhaps for themselves as well.

The problem is that the Texas thrifts really are bankrupt, and the fiction perpetrated by the also-bankrupt FSLIC in keeping them operating can only last so long, as the *Post* editorial continued: "The Fed Home Loan Bank Board, which oversees the S&Ls, has reported that April, the last month for which figures are available, was the eighth consecutive month in which withdrawals from the S&L system nationwide were greater than new deposits. That doesn't amount to a run on the system. But if a run were to begin at one of the bankrupts, there's very little in the fund to stop it. Congress would have to use taxpayers' money from the Treasury."

In fact, regulatory sources speculate that Congress would not have time to act, in the event that a run broke out of control; the Federal Reserve might have to lend directly to bankrupt thrifts, printing the money it required to do so, with disastrous repercussions for the dollar and the U.S. credit system.

Texas gets the runs

The flight of big depositors from Texas savings and loans has been in the works for months, and some of the weaker institutions are still liquid, only because the regulators persuaded stronger institutions to take money from the deposit-brokers, and re-lend it to their weaker brethren. How many more days or weeks the support operation mounted by the FHLBB can last, is far from clear. "I wouldn't call it a run, I'd call it a gradual and persistent withdrawal of jumbo deposits," i.e., large deposits from institutional investors not protected by FSLIC insurance, Joe Selby of the Dallas Federal Home Loan Bank told journalists.

Part of the thrift industry is still profitable, and wants to remain so, by avoiding the bill for the bail-out of the collapsing part of the industry. Senior analysts at the Federal Home Loan Bank Board, which regulates the thrifts, believe that larger S&Ls are "inciting to riot" against the so-called "zombie" institutions, doing their best to provoke a run against their deposits. Unless the Treasury (or Federal Reserve) steps in to bail out the dying S&Ls with money borrowed, taxed, or printed, the stronger institutions will be left to pay the bill. "We have a system where the survivors pay," one analyst commented, "and they don't want to." They prefer to have an old-fashioned panic now, and force the government to come in.

Meanwhile, the vultures from Washington are already circling. On May 17, the *Houston Post* quoted Criminal Division chief Weld saying, "The nation's financial institutions remain increasingly vulnerable to enormous losses brought about by insider fraud and misconduct." Weld said

FIGURE 1
Savings banks' troubles correlate with economic distress

Key

The 14 states where savings institutions lost money, on average, in the first half of 1986

The 18 states with the worst economic problems as measured by unemployment, personal income, and housing starts

Source: United States League of Savings Institutions.

that weak or failing institutions are vulnerable to takeover by "unscrupulous" promoters for a relatively small investment. He said that by using FDIC or FSLIC certificates as a "drawing card," these unscrupulous bankers can offer "jumbo" certificates of deposit at above-market rates to attract depositors, then use the funds to make loans on speculative projects.

Weld said that some of these speculators might even use the funds to buy up other weak financial institutions. "With two and more institutions involved, the scheme becomes more sophisticated through a complex network of reciprocal lending or back scratching," Weld said. "Organized crime is aware of this weakness in the system and has exploited it."

Meanwhile, the Federal Bureau of Investigation has declared bank fraud its number-one priority in the region, and added 30 agents in Texas and Oklahoma. The Justice Department itself is adding five fraud specialists to the Dallas U.S. Attorney's office.

Department of Justice Criminal Division official Steve Learned said Dallas will get the help, not only due to the backlog of cases, but because of anticipated bank and thrift failures in the area. He cited recent testimony by Roy Green, president of the Federal Home Loan Bank in Dallas, that between 21 and 28 thrifts are "hopelessly insolvent" and that closing them could cost the FSLIC $5-8 billion. "When you have that kind of statement, you have to prepare," Learned said.

But in California, where savings and loan associations form the backbone of the Republican funding apparatus, U.S. Attorney for Los Angeles William Bonner, and U.S. Attorney for San Diego Peter Nunez, testified before congressional hearings June 14 that they did not have resources to follow up regulators' recommendations for fraud prosecution.

It happens that some of the Texas thrift operators prominently mentioned in press accounts as targets of the Justice Department investigation, are close associates of Speaker Wright. Ed McBirney of Sunbelt Savings (known locally as "Gunbelt Savings"), Jarret Woods of Western Savings, Don Dixon of Vernon Savings; and Tom Graubert of Independent American Savings, are prominent Democratic political contributors. Press accounts allege that they engaged in a speculative orgy of real-estate lending, taking their profits, and leaving the FSLIC holding the bag when they inevitably crashed.

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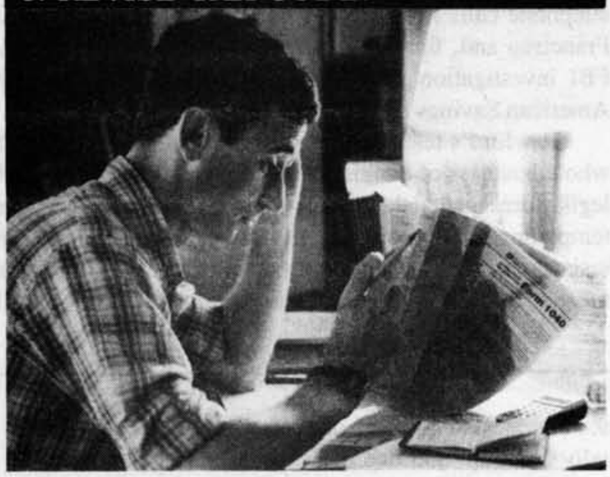
How to stop the economic collapse

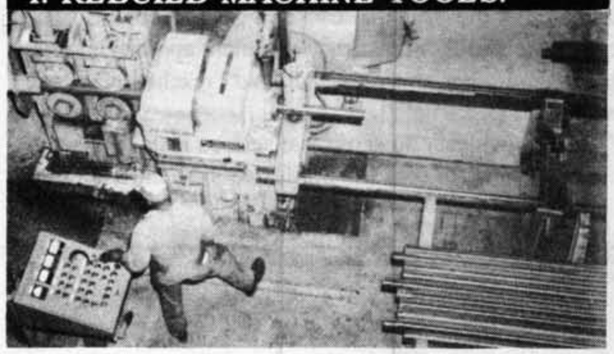
1. STOP BANK CLOSINGS.

3. REVISE TAX CODE.



2. GIVE CREDIT TO PRODUCE.

4. REBUILD MACHINE TOOLS.



The following is excerpted from a response by 1988 Democratic presidential candidate Lyndon H. LaRouche, Jr., to President Reagan's Berlin speech. The response was delivered June 17 during LaRouche's regular five-minute radio broadcast.

Rather than admitting that the Reagan "economic agenda" has been a disaster, the President chooses to seek arms-reduction agreements, which would, in some eyes, justify large cuts in U.S. defense programs. At the same time, the President was lied to about Soviet motives for arms agreements. He was told the lie, that Gorbachov was seeking Soviet arms-reductions in order to relieve the pressure of Soviet arms-spending on a Soviet civilian economy in serious crisis. . . .

Four things must be done to save our collapsing economy and provide an adequate economic basis for effective defense:

1) We must stop the financial crash, by using the regulatory powers of government to prevent banks' doors from being closed.

2) Government must organize low-cost credit in large volumes for investments in the production of useful goods and for financing exports.

3) We must have an emergency revision of the tax-code, with investment tax-credit incentives for expansion in the number of industrial workplaces. My target is not less than 5 million new industrial workplaces during the next four to five years. It is a very realistic objective.

4) Government must assist in rebuilding the U.S. machine-tool industry. The machine-tool sector is the normal channel for delivering advanced technologies into the private sector.

By these methods, we can stop the crash, and launch a real economic recovery. This will enable us to meet our obligations to the general well-being of all Americans, including the tens of billions of dollars we must spend in the war against AIDS.

It will also enable us to afford an adequate national defense.

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Early this year, congressional sources report, California Savings and Loan Commissioner William Crawford—a Republican savings banker appointed by a Republican governor—came to Washington to ask the help of Democratic Congressman Doug Barnard (D-Ga.), the chairman of the Government Operations banking subcommittee. He had been unable to convince either the California authorities (e.g., Attorney General John Van de Kamp), or Meese's U.S. Attorneys in California, to act on evidence he had accumulated that a massive and widespread pattern of fraud was bleeding the California thrift industry. Barnard sent staff investigators to California in April, and in June issued a report demonstrating that the (overwhelmingly Republican) savings banks in California were cheating, and that the Department of Justice had no interest in doing anything about it. California S&Ls have assets of $311 billion, almost a third of the national total.

The report was released at hearings in Los Angeles June 13, where Barnard's staff argued that collapsing real estate, oil, and farm prices in the Southwest and other depressed regions are not the principal cause of S&L problems. The price collapse merely unmasked fraudulent appraisals, insider loans, and other abuses, which had "reached epidemic proportions."

"There is evidence to show that serious insider misconduct is implicated in most of California's 31 thrift failures over the past three years, that appraisals were used to facilitate much of this misconduct and the fraud is responsible for a large percentage of the $3.7 billion in accompanying losses" to the Federal Savings and Loan Insurance Corporation, according to a staff memo. In 1984, Barnard's staff argued that misconduct was a key factor in 25-30% of S&L insolvencies; now, they argue fraud plays a major role in 80-90% of such failures.

Barnard's staff faults the Federal Home Loan Bank Board for lacking an aggressive policy of referring criminal cases to law enforcement officials, a charge that FHLBB officials vehemently deny. The evidence went regularly to the Justice Department, with recommendations for prosecution, but the Justice Department failed to act, they reply.

Barnard's star witness at the hearings was Commissioner Crawford, who detailed a pattern of federal inaction that ultimately could cost the insurance fund billions of dollars. On one occasion, for example, Crawford had to make 17 telephone calls in eight days to the FBI, the FHLB of San Francisco and, finally, a U.S. senator, to try to prompt an FBI investigation into allegations of corruption at North American Savings and Loan.

Crawford's testimony amounted to an indictment of the whole business of banking deregulation. "Congress and the legislatures loaded the system in favor of cheating. If you put temptation and opportunity in front of greed, people can't resist. . . . I won't say it got out of hand in California any more than anywhere else. There's crooks that got into the

Organized crime to take rap for monetary crisis?

Possibly with a view to the 1988 election campaign, the Reagan administration is building an alibi for the collapse of the thrift industry, which is likely to take the banking system with it. This time round, the crash will be blamed on organized crime, the Justice Department appears to be saying. A June 17 feature in the *New York Post* exults, "An investigation by the *Post* into the record-breaking collapses of savings and loans and small commercial banks—closing their doors at the rate of one every business day—has uncovered widespread allegations of fraud and racketeering.

"Linked financing—the process of arranging deposits with the understanding that they will be quickly loaned to designated recipients—is credited by the government with playing a central role in the $25 billion crisis that has left the Federal Savings and Loan Insurance Corporation virtually bankrupt and one of every three S&Ls and small banking institutions broke."

The *Post* story centers not on Texas, but on New York's Mario Renda, the nation's biggest deposit broker, who placed pension-fund and other institutional money with small banks looking for funds, in denominations of $100,000—the limit which the FSLIC guarantees per depositor. Renda's First United Fund Ltd. handled $6.5 billion per year. Renda, who was "indicted [June 16] in an underworld scheme to skim $16 million from two New York unions," allegedly arranged deposits in return for loans to his real-estate enterprises.

Whatever Renda's organized-crime credentials, it does not appear to have occurred to either federal prosecutors, or the *Post,* that "linkage" of deposits and loans is the basis of normal banking business. Whom else do banks lend to, except their usual depositors? The thin line between legitimate high-stakes "speculation" and outright fraud in the real-estate industry might consume the time (and retainers) of a large part of the legal profession for some years to come.

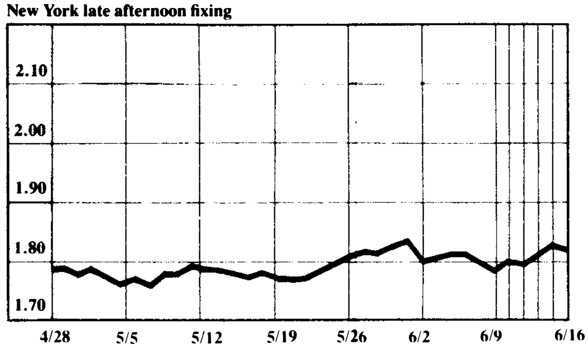
business, but that's because the government lowered the standards."

Specifically, banking deregulation allowed savings banks to make direct investments in real estate, rather than merely make loans. The dangers implicit in direct investment are obvious; they are analogous to commercial bank ownership of corporate equity. If a commercial bank can speculate in the securities of the same corporations it finances, the result is a 1929 crash; if savings banks can speculate in the real-estate market they finance, the result is the real-estate market disaster now in the works.

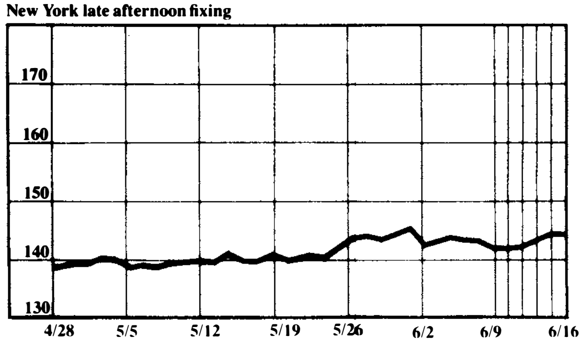
California's Commissioner Crawford appears to be the only public figure in the chaos to state the truth simply: By lowering standards of lending, the Reagan administration created conditions where "normal" lending operations are differentiated only finely from fraud.

Currency Rates

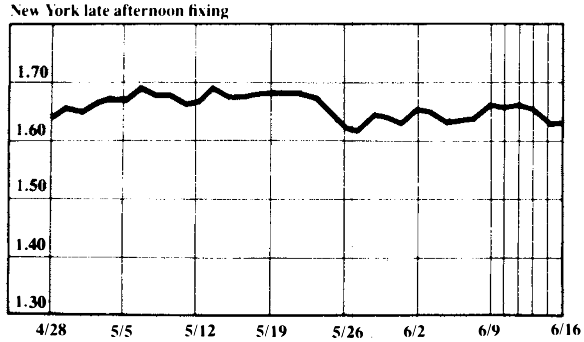
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing