Click here for Full Issue of EIR Volume 18, Number 4, January 25, 1991

The Bushmen's banking reform proposals could never work

by John Hoefle

The Bush administration's planned banking "reform" will not save the U.S. banking system; rather, it will destroy it. Under the envisioned measures, the American system of banking, in which local banks supply credit based upon intimate knowledge of the capabilities and needs of the local economy, will disappear. Taking its place will be a British-style banking system, dominated by a handful of parasitical giant banks whose only interest in local economies is the amount of physical wealth which can be sucked out of them.

Under the guise of reform, the administration plans to establish a virtual bankers' dictatorship, under which this handful of surviving banks will have control over the availability and distribution of credit, the very life-blood of the economy. The needs of individuals, farmers, businessmen, state and local governments, and even of the federal government itself, will be subservient to the demands of the bankers and their Olympian controllers.

The key elements of this scheme—a scheme which is fascist in the fullest sense of the system set up by Hitler's economics minister Hjalmar Schacht—have been stated repeatedly by administration officials, including President Bush, Treasury Secretary Nicholas Brady, Securities and Exchange Commission head Richard Breeden, and Federal Deposit Insurance Corp. (FDIC) Chairman William Seidman. But make no mistake: These men are mere salesmen for policies decided at a much higher level than mere politicians.

License to plunder

The major elements of the reform proposal are:

- streamlining the regulatory process;
- eliminating restrictions on nationwide banking;
- eliminating barriers among commercial banks, securities firms, insurance companies, and other financial and non-financial companies; and
- restricting the scope of deposit insurance.

The regulatory process would be streamlined by combining the bank regulating functions of the Federal Reserve, the Office of the Comptroller of the Currency, the FDIC, the Office of Thrift Supervision, the Resolution Trust Corp., and the National Credit Union Administration into one "super-regulator" with control over the nation's banks, savings and loan institutions, and credit unions.

The effect of this move would be to increase the power of the Federal Reserve System, a private institution which has usurped the constitutional power of the federal government to regulate the creation of money. While the Federal Reserve would give up regulatory oversight of the nation's 6,444 bank holding companies, it would in turn receive total authority over the nation's 50 largest commercial banks. All other banks would be delegated to the so-called "super-regulator." Banks in this second group will be looted in order to keep the first tier banks alive, and the Federal Reserve will wind up as the sole bank regulator.

The elimination of restrictions on nationwide branch banking will allow the Federal Reserve's favorite banks to rapidly establish nationwide branches, either buying up or running out of business their local competition.

Since the major banks are in such dire financial condition, the intention is to not only allow them to expand their income by selling securities, insurance, and the like, but also to allow them to merge with securities firms and insurance companies. However, given the financial condition of the securities and insurance companies, that is not enough. So the administration is planning to let non-bank corporations buy banks. Besides allowing huge corporations like Ford and General Electric to own banks, this will also open up the banking system to attack by corporate raiders.

No deposit, no return

The final major aspect of the banking proposal is the reduction of deposit insurance. The major problem with deposit insurance, from the regulators' point of view, is that it makes the local bank just as safe a place for customers' deposits as the big banks. That makes deposit insurance a major obstacle to consolidation. Reducing or eliminating government deposit insurance will force depositors to flee the smaller banks for the perceived safety of the giants.

© 1991 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

But the decision to cut bank deposit insurance is quite tricky, since the perception that deposits are backed by the federal government is the only thing standing between the banks and massive runs on deposits. In fact, such runs are already under way, not only in New England, but also in New York and other parts of the country.

To make this fascist reorganization palatable to the public, the regulators and the bankers are attempting to portray it as a way to ensure that the taxpayers don't get stuck with the tab, as they did in the S&L fiasco. The big problem with this consolidation scheme, of course, is that it will cost a lot of money—money that neither the bankrupt banks nor the bankrupt FDIC have.

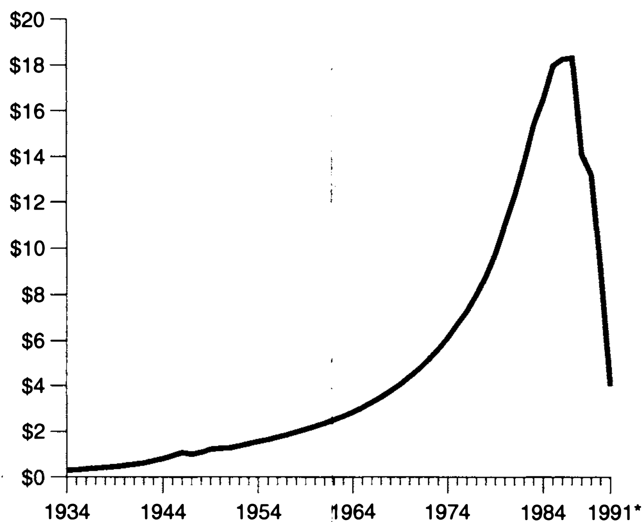
The FDIC is hopelessly insolvent. The agency's Bank Insurance Fund (BIF) peaked at $18.3 billion in 1987, and has dropped like a rock ever since (see **Figures 1** and **2**). By the end of 1990, the BIF contained just over $9 billion, a 50% drop in three years. By the end of 1991, the FDIC estimates, the BIF will have only $4 billion to back some $2.5 trillion in insured deposits, or about 18 cents for every $100 in insured deposits (see **Figure 3**), and even less compared to total deposits.

To remedy this, the administration is considering several

FIGURE 1

Size of FDIC Bank Insurance Fund, 1934-91*

(billions $)



* FDIC estimate
Source: FDIC

How the banking system collapsed in 1933

The rapid escalation of bank failures in the United States today recalls the banking crisis of the 1930s, when the federal government was forced to declare a bank holiday and shut down the entire banking system.

The collapse started gradually. Between 1904 and 1920, some 1,170 of the nation's banks failed. That number jumped to 5,624 between 1921 and 1929. After the stock market crash in October 1929, the crisis deepened, and 3,635 banks failed in 1930 and 1931 alone.

The final phase of the banking crash began in October 1932, three years after Black Friday, when Nevada declared a statewide banking moratorium. As Christmas approached, sporadic runs hit country banks in parts of the Midwest and Pennsylvania.

In January 1933, the runs spread to Memphis, Little Rock, Mobile, Chattanooga, Cleveland, and St. Louis. By early February, they had spread further to Baltimore, Nashville, San Francisco, New Orleans, and Kansas City. On Feb. 14, 1933, Michigan Gov. William A. Comstock closed all the banks in the state. On Feb. 24, Gov. Albert C. Ritchie declared a three-day banking holiday in Maryland. Three days later, the seven member banks of the Cleveland Clearing House Association limited withdrawals from their 103 branches. Similar restrictions were imposed in Akron and Indianapolis. Before the following dawn, the legislatures of Ohio, Pennsylvania, and Delaware amended their banking laws to allow regulators to limit withdrawals by depositors.

On March 1, bank holidays were declared in Alabama, Louisiana, and Oklahoma. The next day, banks were ordered shut in Texas, Oregon, Arizona, Idaho, Nevada, Washington State, and Utah. Visitors arriving for Franklin Roosevelt's inauguration found notes in their hotel rooms announcing that no out-of-town checks would be accepted.

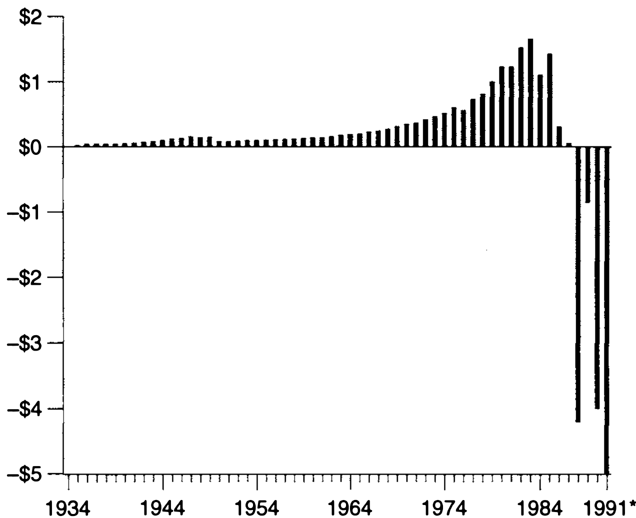
On March 3, four more states—Missouri, Wisconsin, Georgia, and New Mexico—declared holidays. After midnight, a few hours before the presidential inauguration, state moratoria were declared in New York and Illinois. That was the knockout blow: By breakfast, every state that still had banks open, closed them.

It took from October 1929 until March 1933, nearly three and one-half years, for the financial blowout triggered by the stock market crash to bring the entire banking system to a halt. By that schedule, the events of October 1987 would bring down the U.S. banking system in March 1991.

FIGURE 2

Net income of FDIC Bank Insurance Fund, 1934-91*

(billions $)

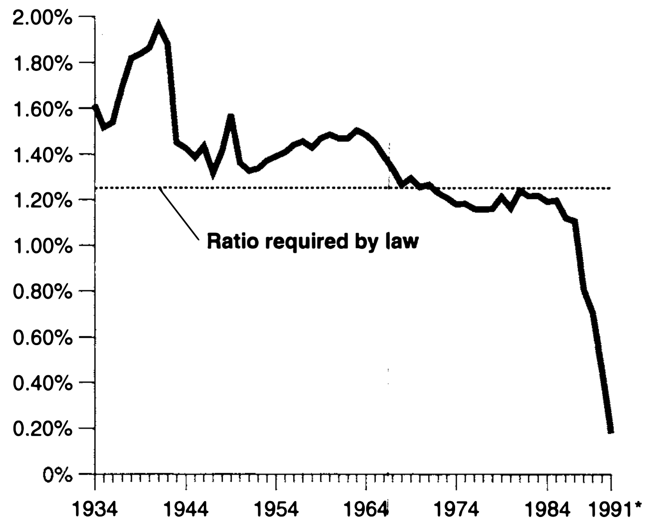


* Projected
Source: FDIC

FIGURE 3

Ratio of Bank Insurance Fund to insured deposits in U.S. banks

(percent of insured deposits)



* FDIC estimate
Source: FDIC

proposals. FDIC chairman Seidman has proposed assessing the banks a one-time special fee of 1% of their total deposits, on top of the 19.5 cents per $100 in deposits rate they already pay. This fee would raise $28 billion. Others, including the Association of Bank Holding Companies, favor a one-time fee of 0.5%, with the proceeds going to a joint private-government bailout fund. Considering that the banks reported a total profit of $25.2 billion in 1988, $15.6 billion in 1989, and $15.5 billion through the first three quarters of 1990, that means that Seidman wants as much as two years' profits of the banks (see **Figure 4**). And judging by the way things are going, it could take a lot longer than that for the banks to earn the $28 billion.

The final details of the administration plan may differ somewhat, as concessions are made to various political and economic factions; but the basic thrust will not change. The administration's intent is to protect the big banks, no matter what the cost to the nation's economy and the public.

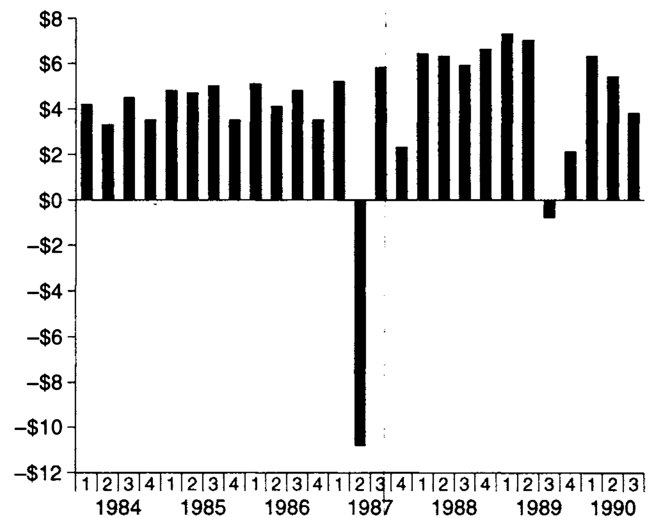
The idea that the bankrupt banks can somehow pony up enough money to fund their own bailout is nonsense. That is merely a cover story for public consumption. The fact is, the bank bailout will fall squarely on the taxpayers' shoulders, and the amount will dwarf that of the S&L bailout, which is itself part of the same consolidation operation.

The administration's financial dictatorship will not restore economic health—just the opposite. It will destroy any hope of economic recovery by putting the vampires in charge of the blood bank.

FIGURE 4

Quarterly net income of FDIC-insured banks, 1984-90

(billions $)



Source: FDIC