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The Bailout of SLIC Today and FDIC Tomorrow

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Congress is considering legislation that attempts to cope with the crisis of the Savings and Loan Insurance Corporation - the SLIC - and the underlying S&L's. The S&L industry has always had a powerful voice in Congress. One of the most potent alliances in American politics has been between building contracters, the construction unions, and the S&L's, which furnished the mortgages on which the well being of the other two depend. The contracters, building unions, and S&L's have always stood ready to help finance campaigns, and besause of the nature of the allies they always get a by partison hearing when Congress addresses their problems.

The crisis is simple: the Federal Savings and Loan Insurance Corporation whose seal is on the doors of all insured S&L's and is prominent in their advertising is broke and so are hundreds of S&L's. The deposit liabilities of the broke S&L's so exceed the reserves of the FSLIC that the agency cannot liquidate institutions that are bankrupt and pay off the insured deposits. These bankrupt institutions are able to accept and retain deposits because the public believes that the seal on the door means that they are recieving or holding a United States Government liability when they recieve a deposit.

This is strange Socialism we have here. These failed institutions have no capital except the underwriting of their liabilities by the government. No capital means that there are no stockholders with money to lose if such an S&L makes further losses. Having no or a negative capital means that the price in the market of such government wards is very low, for a pittance it is possible to get control of such organizations and hundreds of millions nay billions of dollars of assets.

An old populist saying is that "A bank charter is a lisence to steal". A zero net worth organization that is in business only because it has a blanket coverage of its liabilities from the government - only a fool or a financial idiot would have an uninsured deposit in a no net worth institution - is an invitation to manangement to convey some of the assets of the bank to their private "purse"; such organizations are not mere lisences, they are invitations, to steal.

Deposit insurance was never insurance that could cover an epidemic of bankruptcies such as we now have. Deposit insurance can cope with individual failures that are due to isolated incompetence and malfeasance. Todays bankruptcies are due to systemic conditions.

What we are witnessing is the result of cumulative changes in financing practices since 1946. These changes transformed the lightly indebted and financially robust private sectors of the end of World War II into today's heavily indebted and financialy fragile sectors. Financial institutions changed their character and new and quite tricky financial instruments were developed. The quarter of a billion dollar hit that Merrill Lynch recently took could not have occurred in the financial world of 1950, 1960, 1970 or even 1980. The array and diversity of both assets and libilities that S&L's now carry on their books would have been clearly forbidden even as little as a decade ago.

When deposit insurance was introduced in 1934 the full faith and credit of the United States was pledged, not openly but covertly, to assure that the failure of banks and thrifts to redeem their deposits, which is what took place in the great contraction of 1929-33 would not again happen. However the guarntee that was set up was from a Federally chartered corporation that was to collect a premiums by assessing deposits in the insured institutions. From their beginning in 1933 until now the fund was adequate to handle the payouts made necessary by failures or to replenish the capital of institutions that were deemed too important to fail.

Underlying this failure is an unwillingness to accept how precarious the economic situation is. All that stands between the current sluggishness and the worse recession since 1929 is deposit insurance.

At the doors of a savings and loan association the familiar seal which attests that the organization is insured by an agency of the United States government is displayed. Congress is now debating what that seal really means, for the cash needs of the FSLIC far exceed what its on hand reserves can cover. Not only are many Savings and Loan Associations covertly bankrupt but so is the FSLIC.

The cash bind of the FDIC and the commercial and mutual savings banks it insures is not as extreme as that of the FSLIC and its clients. Nevertheless a tough minded appraisal of the value of bank assets would throw a large enough number of banks into bankruptcy so that the reserves of the FDIC will be exhausted. As far as the bankruptcy of the deposit insurers is concerned we can assert FSLIC today and FDIC tomorrow.

funds needed 40billions

Larceny in institutions that are bankrupt but which are not allowed to fail

The need for a rfc

The future structure of finance is at issue.

Competetiveness requires a financial structure that reachesw deep into the economy and which is not biased towards the rich and the already successful.

What we are witnessing today is some chickens coming home to roost.