Breathing room for the S&Ls

Kathy Burdman asks, will the S&Ls challenge high interest rates, after the President saved them from takeovers?

President Reagan's Cabinet Council on Economic Policy endorsed a plan to provide up to $2 billion in emergency letters of credit to the nation's savings and loan associations, which have been driven close to bankruptcy by the high interest-rate squeeze of Federal Reserve Chairman Paul Volcker. In its May 29 decision, the cabinet group also flatly rejected Volcker's proposal for "emergency supervisory mergers" that would have allowed big New York and California commercial banks and S&Ls to move across state lines and snap up weakened local S&Ls.

The cabinet action, clearly at the personal directive of the President, came after vigorous lobbying by the U.S. League of Savings Associations against the Volcker legislation. In a series of intense meetings with presidential counselor Ed Meese, White House domestic policy deputy director Edwin Grey, and other officials close to the President, League officials went over the head of Volcker and Treasury Secretary Donald Regan, who had loudly opposed any so-called bailout for the S&Ls, to obtain the emergency credit plan.

The credit plan

Under the new "demand notes" plan, the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation would issue up to $2 billion in letters of credit to S&Ls whose net worth, defined as the excess of their assets over liabilities, falls below 2 to 3 percent, Deputy Treasury Secretary R. T. McNamar told the press. The S&Ls are basically sound, he said, and "neither depositors nor mortgage holders are in danger of being hurt, but the institutions do have a major earnings decline" caused mainly by high interest rates. It does not require legislation.

The Reagan cabinet action represents the first clear defeat for Volcker and his ally Secretary Regan, who only minutes before the cabinet meeting told the press that if "the thrifts are losing money, so what? Every time a company loses money, is the federal government supposed to go in and make it whole?" Regan said that the S&Ls should have anticipated a proverbial "seven fat years and seven lean years" and "put aside reserves" in case.

U.S. League President Roland Barnard told *EIR*, "The public is aware that the U.S. Treasury . . . is responsible for letting banks go." As a result of the League's discussions with Meese and others closer to the President, Barnard said, "The point was gotten across to the administration."

But this is only the first step, for the plan "doesn't give us any new credit for lending," Dean Cannon, California Savings & Loan League executive director, told *EIR*. "The administration's offer is a ray of light." So far, however, he said, the White House has refused to promise the vital interest-rate relief. "We've been advocating this program," said a top U.S. League source, "but it only provides capital for book purposes. It doesn't give us a nickel for lending to the homebuilding industry."

In desperation, some S&L leaders propose measures as extreme as a return to *consumer credit controls* such as those imposed by Jimmy Carter in March 1980. On May 7, League Legislative Affairs Director Stuart Davis, head of the giant Great Western S&L in Los Angeles, advocated "direct credit controls" in testimony before the Senate Banking Committee.

The U.S. League's executive committee voted May 15 to urge Congress and the administration to "expedite balancing the federal budget, or to impose selective credit controls if the budget cannot be balanced quickly enough to bring interest rates under control."

"It's a drastic measure, all right, and we don't really intend to push it that seriously," said a top U.S. League source, "but you have to realize the situation of our individual members is worse than drastic. The 1980 credit controls may have collapsed the industrial production index—but they brought short-term interest rates down from 20 to 9 percent, and people took out a lot of mortgages at 9 percent. We'll support World War III if it brings interest rates down to 9 percent. We're for lower interest rates, period. We're a totally frustrated group of businessmen who are being forced to close doors by the policy of the Federal Reserve."

The U.S. League is expected to use the call for credit controls, which has no chance at all with the Reagan administration in any situation short of a bank run, to dramatize its demand for the ouster of Paul Volcker and the reversal of his interest-rate policy

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

S&L spokesmen talk about credit policy

U.S. League President Roland D. Barnard told EIR *that the League's opposition to Volcker's bill for commercial bank takeovers of S&Ls produced a defeat for the Fed this week. Mr. Barnard is president of Midland Federal Savings & Loan in Denver, Colorado.*

EIR: Is President Reagan responding to the U.S. League's criticisms of Fed Chairman Paul Volcker?
Barnard: We weren't talking about Volcker in particular, but we explained to the administration the need to ensure the viability of the S&Ls and improved our direct contact with the White House in several meetings in May. We fought the Volcker bill for supervisory mergers, and we told everyone we were going to fight it. We're not going to give the regulators a wide-open loose-hinged door to do whatever they choose with the thrift industry. Congress has to get control over the regulators, and we are preparing our own bill which would allow selected mergers, carefully spelled out. But we can't have Citibank allowed to go into Utah and underbid local banks to take over every bank in an open free-for-all.

EIR: So you consider the resolution against the Volcker legislation a victory?
Barnard: Yes.

EIR: The administration's $2 billion alternative "demand notes" program to aid ailing S&Ls, was circulated by the Treasury in spite of Secretary Regan's opposition. Was this your proposal, and how do you explain the Treasury's about-face?
Barnard: We have made suggestions of this kind, on the grounds that we must keep these institutions viable and at the least possible cost. We've said that the FSLIC [Federal Savings & Loan Insurance Corporation] could better lend money now than to pay the higher costs of mergers and acquisitions of failing S&Ls, and this has been adopted. The present proposal is far better than closing institutions or allowing interstate takeovers. These are savings institutions which are well-managed, and have done the job that they are mandated by Congress to do, which is to finance home lending at regulated rates. It is the high interest rates we now have that are the only cause of their inability to pay these rates and still continue to do their job in housing.

The Treasury Department did not always see things this way... I've personally explained it to the White House and to the chairmen of all the congressional committees. Until now the Treasury has expressed the attitude of "Just let the rotten fruit fall." That isn't helpful in any way, not in any way conducive to solving the problem. . . .

The people who administer the law just decided that these institutions are a pain in the neck. . . . and the public is aware that the U.S. Treasury is responsible for letting banks go, for saying there are "just too many financial institutions." It is absolutely ridiculous to imagine that kind of power vested in any part of government.

Somebody's going to be found floating on top of the water if they try this. Any government official who thinks that the federal government can walk away from a legal financial responsibility and obligation which they have under the laws . . . which were created under President Roosevelt, had better change the law first. . . . When well-managed institutions cannot operate because of conditions outside their control, the government has an insurance responsibility. And they've got about as much chance of changing the law as I have of flying away right now. The point, in short, was gotten across to the administration [by the U.S. League] that they *are* going to take responsibility for their legal obligations and honor their requirements. It is only the government that is making trouble for any well-managed financial institution that is in trouble today.

EIR: Does the White House's openness mean willingness to pressure Volcker to bring down interest rates?
Barnard: The policies being followed by certain parts of the government, including the Federal Reserve, are certainly open to question. These regulatory agencies have power of life and death over our institutions. The Depository Institutions Deregulation Act stated that above all else, that no deregulation provisions should be carried out that would do damage to thrift institutions or that would disable housing. And I'll be darned if that has been followed as it should have been.

The Fed's policy on interest rates has yet to prove itself, and has yet to show whether this ravaging situation will continue. It seems that Mr. Volcker is fully intending to hang on to high interest rates as long as he needs to.

The problem, however, in my view is that the Fed's been doing it alone. I believe that inflation is not caused by high interest rates alone, but mostly by the recalcitrant Congress and the rest of government who have given no care to cutting spending and stabilizing the economy. The Fed, in my opinion, is in an offensive mode against the damage done by the rest of the government. The Fed did not create this inflation. The Fed in fact is the only one out there trying to fight inflation, and the problem is they cannot do it alone.

We must get the President's program passed, that is the only way to resolve this. The administration is acting according to the will of the people.

We have some disagreements with the content of the President's tax program, and we've introduced the All Savers bill and other tax bills which would give a $1,000 or $2,000 tax break to savers and get billions in deposits into savings institutions for loans to housing. . . .

Leonard Shane, President of the California Savings and Loan League, told EIR *that the Fed's interest rate policy has been such a failure that California S&Ls are ready to consider the extreme measure of credit controls to attempt to bring interest rates down. Mr. Shane is president of the Mercury Savings and Loan in Huntington Beach, California.*

EIR: What is the California League telling the President about Chairman Volcker?
Shane: Our industry, both in California and nationally, and with great support from other industries, is taking the view that the Fed's policy is just not working. It's been a failure at getting inflation down. Interest rates are higher than ever and the homebuilding industry and other industries are suffering tremendously. We must have lower interest rates.

EIR: Are you asking the President to remove Volcker or reverse his policy?
Shane: We're doing everything we can to get interest rates down. We have worse problems with the Secretary of the Treasury. Mr. Regan believes we should fend for ourselves in this environment, which is impossible. Deregulation is killing us, and the interest-rate environment is killing us. In fact I made a pitch yesterday for *reregulation*. The "level playing field" idea in which S&Ls have to compete with big banks and money market funds for deposits doesn't work. It didn't work for the Christians with the lions—that was a level playing field. Society has a right to regulate and defend itself.

In fact I believe that there is only one thing which will work to break the back of the interest-rate spiral—credit controls. I mean the same sort of controls which we had in March 1980—full controls on consumer credit, reserves or retail credit, reserves on credit cards, and especially reserves on money market funds.

EIR: But those controls brought on a major recession.
Shane: They cut down consumer lending, it's true, but what interests me is that they brought down mortgage rates from 15 percent to 9 percent, and we started making mortgages again. It brought down interest rates, and that's my concern.

EIR: You may have done more immediate business, but had the controls continued people would have not been able to afford homes because of the unemployment.
Shane: We want interest rates down, now, and this is the only method available to us to do it. We can't wait weeks and months for rates to fall or for the Fed to change its policy. Until now, we've just been "anti," against the Fed. Now we have an alternative proposal. And it's my feeling that Mr. Volcker is beginning to listen.

Dean Cannon, executive director of the California Savings & Loan League, tells EIR*'s Kathy Burdman that the local S&Ls have one clear message to the President.*

EIR: Do you believe Volcker should continue at the Fed?
Cannon: We're not happy with his performance. We feel he's not done all he can to bring short-term rates down. This is the one issue on which we've been hammering away at Washington, and we've not been too successful thus far. There's been a lot of agitation out here on the issue. We've been meeting with every top executive of the Reagan administration and Reagan people here in California to make sure they understand the severe financial troubles this is causing the home lending industry. We're not just crying "wolf," we're in real trouble now, and they are beginning to understand that. We're telling them to get short-term interest rates down right away before we have to close our doors.

EIR: What kind of response are you getting at the White House?
Cannon: They understand the problem, but so far they've been unable to help. They say, "If we don't hold the economy's feet to the fire, inflation will take off again. Let our economic gameplan work, give it time to work." But for those who are hurting so badly today, they can't wait, there isn't time for it to work. They say we're not hurting badly enough for them to change their attitude on interest rates at this point.

They'll move, I think, when they see that the troubles we are having may spill over and hurt their entire economic program. To the extent that we do begin to close our doors, they have to ask themselves, at what point will there not be sufficient funds in the Federal Deposit Insurance Corporation to insure depositors, because then the Treasury will have to spend a great deal of money saving depositors, and all the budget projections will go out the window. Whether that happens depends on the administration's willingness to get interest rates down. If savings institutions begin to go, the public's crisis of confidence will spread to all financial institutions.

I think that the administration's offer of $2 billion in demand notes is a ray of light, the first sign I've seen that they are moving in the right direction. It's a good program. But short-term letters of credit are not a solution to the problems we have been having in general. They help to shore up the capital of failing institutions at the margin, but they don't give us any new credit for lending. We need a drop in short-term interest rates.