EIR Economics

Texas bank failure shows cracks in the system

by Chris White

Houston's biggest bank, First Citicorp, associated for a long time with the big respectable names of Texas politics, like Connally, Strauss, Elkins, and Armstrong, has gone belly-up. The 62 banks held by the company are being offered to Robert Abboud, Chicago-based protégé of the Soviet super agent, the aging Armand Hammer, with Federal Deposit Insurance Corporation underwriting of well over $1 billion.

The failure is the second biggest in American history, after the 1984 failure of Continental Illinois. That tremor in the financial world was barely contained. The question whether the sequelae of the Texas bankruptcy will also be, is not so clear.

This magazine had previously warned that the Houston bank would be a likely candidate for rapid demise, among other Texas so-called oil patch banks. Others seemed to share that view, including a whole gaggle of directors of the failing institution, who, like Anne Armstrong, of King Ranch and the President's Foreign Intelligence Advisory Board fame, Elkins of the law firm Vincent and Elkins, and Theodore Strauss, the brother of Democratic Party honcho Robert Strauss, quit their positions back in July, and bailed out of the sinking ship. They probably were seeking to escape legal claims for damages against the directors responsible for the disaster.

Others, too, had been offered the bank. A Japanese consortium has been asked to step in with bail-out funds. The Japanese, for their part, said "No." They probably realized that the combinatio of rotten oil, real estate, and Third World liabilities, doomed the Texas giant no matter how much new money was to be poured in.

That should be a warning sign to others who have let it be known that the Japanese can be counted on to help bail out the failing U.S. banking system. The failure of Houston's First Citicorp demonstrates that such thinking is actually way out of line.

Then, the bank had offered itself to other buyers, in this case the Royal Bank of Scotland from Edinburgh. The canny Scots weren't overly tempted to put their good money after so much bad either.

Within Houston, the MCorp had scrambled to secure FDIC backing for its own takeover of the failing institution. MCorp calculated that such an FDIC credit line would, rather than securing First Citi, permit the recapitalization of MCorp itself. The FDIC turned down that approach in favor of extending the federal teat to Hammer's protégé Abboud.

Now, the *Wall Street Journal* crows that the independent financial power of Texas has been broken, and gloats that Texas banking can be assimilated into the East Coast-based commercial banks' system, presumably for assimilation through asset-stripping.

It ought readily to be conceded that there is a certain craziness to that kind of thinking. Why? Well, the so-called triumph may indeed prove to be short-lived. There isn't going to be too much to gloat about if the destruction of the Texas banking center turns out to be the prelude to the collapse of the banking system as a whole.

Prelude to general blow-out?

It's been conventional wisdom, since the oil price nose-dived below $15 and then $12 a barrel in the early weeks of 1986, that the so-called oil patch banks had run into deep trouble. This magazine was among the first to point out that the concentration on oil lending, serious though it still might be in disaster potential, paled into insignificance relative to the speculative real estate bubble in which Texas and other banks had become entrapped. The real estate bubble, facilitated by Treasury Secretary Donald Regan's modifications of the tax system in 1981 and 1982, had been one of the principal inducements for foreign flight-capital to enter U.S. markets, for government-protected easy returns, during the early phases of the "Great Bull Market" of the mid-1980s. The real estate bubble was knocked out by what the President and his advisers call the "historical" tax reform passed in 1986. The elimination of tax breaks on real estate speculation, eliminated protection for what normal people would consider to be a large-scale swindle, and prepared the way for the collapse, as we have shown, of up to $250 billion worth of the paper associated with the bubble.

That's what is now coming down the pike, and it's not just a Texas, or "oil patch" region problem. It's actually a crisis which threatens the very integrity of the national banking system. If left to run its course, there won't be any winners for the *Wall Street Journal* to gloat about. Unlike the National Football League, there are only going to be losers in this one, unless the policies that have caused it are changed.

For example, the Federal Deposit Insurance Corporation, which moved to secure Abboud's takeover with over $1 billion, is unlike its counterpart, the Federal Savings and Loan Insurance Corporation. It does actually have some money in its insurance fund. The FSLIC has recently been empowered to "go borrow" from the markets to restock its own empty coffers. The First Citi failure knocks a big hole in the FDIC's resources, and the question must be posed, "How many more such failures can the nation's leading bank insurance operation underwrite?"

Next time its funds are called on, it will most likely not just be one of the larger middle-sized banks, but a handful, from different parts of the country. The evidence for that is abundant. On the West Coast, the once-mighty Bank of America is desperately trying to sell itself to the Japanese to stay afloat. On the East Coast, Bankers Trust, among others, is desperately trying to raise new money. The almost soap-opera quality of the three-year decline of the Bank of America into insolvency, is only the most lurid example of a banking system gone horribly wrong.

Down in Texas, there are some, and they are not alone, nor restricted to that part of the country, who are asking themselves the following. At the end of the second quarter, the banking system had to swallow about $10 billion worth of loan-loss write-offs. Depending on how the charade with Brazil and other situations play out, the end of the third quarter could be even worse. Perhaps the banks would have to chew through another round of paper breakfasts, this time in the order of, say, $25 billion and up. Can the banking system digest that kind of loss? The FDIC certainly doesn't have the funds to do anything about it on a national level.

Meanwhile, Texas, Oklahoma, and Louisiana could account for a significant chunk of the total on their own.

This may come as a big surprise for the President's script writers, who seem to have thought that the uptick in international oil prices alleviated the problems in the so-called oil patch that bubbled to the surface as prices fell. They are the victims of the same kind of incompetent thinking as those European financial big-wigs who argue that the time has come to deflate the world speculative bubble, so that another "boom-bust" cycle can begin. The continued collapse of the oil patch shows what will happen to economy as a whole, if such thinking prevails. It won't bounce back, it will just keep on spiraling down.

Don't ask the bankers

The principal problem is that the people who helped create the mess, like the Texas bank directors who bailed out in the month of July, are still accorded sufficient credibility to be able to dictate what the solutions should be. A few more shoes falling, like the collapse of First Citi in Houston, and it's going to be pretty difficult to maintain the conceit that the first people whose advice ought to be sought on running a banking system, are the bankers themselves. So far they've done a good job of destroying one, and they've been singularly insane on the matter of whether their blunders can, or even ought to be, corrected or not. Soon enough, a banker bearing bankers' solutions to these kind of problems, is going to find himself treated like the bearer of bad news in tragedy.

Fortunately, the question of what must be done will not be left up to the bankers. It's a political question, involving the highest matters of national security. Clearly, the United States doesn't function in the world with a collapsed banking system. Therefore the follies, and ideological incompetences of the bankers and their friends, will have to be, compensated for by executive action, or the United States, and the world credit system dependent on it, will not exist.

There are still many who think that such matters can be postponed until after the elections of 1988. They count, among other things, on the newly appointed political ideologue at the Federal Reserve, Ayatollah Alan Greenspan, the practitioner of Ayn Rand-style magic, being able to help organize such a stalling operation. They count, in short, on their continued ability to manipulate the appearance of what they desire to seem to be going on, without reference to what is really happening.

To such, the failure of First Citi should be a portent that they do not have such powers as their conceit lays claim to. If standing policies on the dollar, credit, and U.S. government finances are continued, it may well turn out to be the case that the U.S. banking system will be the first victim. We don't think there will then be too many stupid enough to argue, as they have on other matters, that "the down-sizing" of the banking industry is the first necessary step toward recovery. New policies will be required before then.