Panic grips Washington over banking collapse

by Chris White and John Hoefle

Political panic is spreading in Washington, as the insolvent, and increasingly illiquid, banking system continues to sink, and the depressionary collapse of the economy accelerates. Despite its continued lying about the "recovery," the Bush administration is in a frantic flight forward, trying to paper over the collapse for the coming election season.

Since Sept. 27, the White House has held a series of emergency meetings with regulators and business leaders, seeking ways to keep up, for a few more months, the illusion that the U.S. economy is still afloat.

Treasury Secretary Nicholas Brady told the Atlanta Rotary Club on Sept. 30 that the public must be convinced that the government is doing all it can to promote the recovery. The administration will take whatever steps are necessary "in the short term to make the economic recovery a reality," Brady insisted. Noting that "we are entering an election year," Brady said, "we must make the economic recovery a reality that is perceived by everyone."

On Oct. 7, Bush and his cabinet met with a group of the country's top corporate leaders to review the economic and banking crisis. Executives from IBM, American Airlines, Proctor and Gamble, and General Mills were among those who gathered. The American Bankers Association sent President Bush a letter outlining its view of what is going on. At the meeting, Bush expressed concern over the "credit crunch," but insisted that the economy was recovering, according to press spokesman Marlin Fitzwater.

One day later, Treasury Secretary Brady chaired the third meeting of the economic policy council in two weeks. The subject, again, was how to alleviate the "credit crunch" allegedly jeopardizing the administration's vaunted "recovery."

Meanwhile, President Bush continues to imitate Lyndon Johnson's lies to the public, when LBJ told Americans constantly over 1965-68 that the war in Vietnam was being won. "I think the economy is recovering," he declared Oct. 4. "I'm optimistic. Thank God this recession hasn't been as deep as previous recessions." There has not been so much attention on economic and financial matters at the Bush White House since May and June of 1990, when the banking and credit system was also standing on the brink.

Propping up the banks

After the Oct. 8 meeting, the administration unveiled a series of regulatory proposals allegedly designed to free up credit. These criminal and insane proposals, which were characterized as "technical" in nature, continue the administration's Orwellian efforts to keep the banks' balance sheets presentable through outright fraud.

The proposals, which are designed to paint bad loans as good, liabilities as assets, and bad news as good—and to reduce the ability of bank examiners to force banks to tell the truth—reflect the growing fear inside the establishment that the U.S. banks may be on the eve of their fatal crisis.

From the Treasury and the Federal Reserve, a scheme has been put forward to permit banks to use their holdings of Treasury bills as deposits placed on reserve at the Fed. This proposal is a violation of all standing U.S. banking practice, under which banks are supposed to deposit their own assets as reserves with the Fed. The idea is, if the banks can use their holdings of Treasury debt for this purpose, then their own funds would be freed to pay down some of their debt, and take further writeoffs of their bad loans.

This is just a cheap swindle preparing the way for the Federal Reserve to nationalize, de facto, the whole of the banking system, as we warned would happen when the Bush-Brady "Bank Reform Bill" was presented to Congress earlier in the year.

The Federal Deposit Insurance Corp.'s (FDIC) reports on bank loan delinquencies prove that this is a complete waste of time. Since the beginning of 1987 alone, the amount of admitted non-performing loans held by banks has exceeded the amount the banks have set aside as loan loss reserves by $338 billion—enough to turn the banks' declared profits of $70.5 billion during the period into a $267 billion loss. That $267 billion loss would be more than enough to wipe out the banks' claimed equity capital of $226.8 billion at the end of the second quarter. And this is just the *admitted* bad loans, the tip of the iceberg. With this proposal, Brady and company are preparing the way for a hyperinflationary explosion, and a worsening collapse.

A new scam: 'residential loans'

Other proposed regulatory changes are equally ludicrous. How about this one as a measure of desperation? It is proposed that some of the banks' outstanding commercial real estate loans be reclassified as residential loans. Empty office buildings which the banks lent money to finance, would henceforth be called residences. It won't help the homeless, nor will it do anything for the banks.

The game here is to preserve the fiction that banks still have equity capital. By declaring commercial real estate loans as residential real estate loans, the banks reduce by 50% the amount of money they have to carry as capital to offset those loans. Banks are supposed to secure their commercial real estate loans to the tune of the full 100% of the loan. Real estate speculative values around the country have collapsed, and the loans of the last four to five years are coming due. They cannot be paid back, nor is the property which secures them worth what the banks lent out. So the Bush crowd is proposing a name change to permit the banks to swallow only half the losses they would otherwise have to eat. The banks' real estate lending totaled $847 billion at the end of the second quarter of this year. If all of it were counted as residential lending, and the $420 billion written off, the amount would still be more than twice their reported capital. But if the losses they have not counted since 1987 are taken into account, their capital has been more than wiped out already, before they begin to deal with however much of the $847 billion outstanding in real estate loans has already gone bad!

The administration will also establish new guidelines to paper over collapsing real estate values, by counting real estate at its alleged long-term value—meaning what it cost at the height of the speculative frenzy—as opposed to its current market value.

It must be "made clear that liquidation value appraisals should not be used" by examiners, Brady told the Atlanta meeting. Brady also called for the "prudent refinancing" of commercial real estate loans "without regulatory criticism," a head-in-the-sand process that would be greatly aided by the artificial values the administration's proposals would permit.

Powder puffs or chain saws?

We do not want bank regulators either "padding [banks] with powder puffs or attacking them with chain saws—you want to be in the middle," said Deputy Treasury Secretary John Robson. To prevent these "chain saw" attacks by what the administration has called "overzealous" examiners, the administration would also make it easier for banks to appeal "unfair" rulings by federal bank regulators.

"The administration is taking steps to address this problem, and John Robson has taken the lead for Treasury." boasted Brady in Atlanta. "For over a year, John, Alan Greenspan of the Federal Reserve, Bob Clarke of the Office of the Comptroller of the Currency, Bill Seidman of the FDIC, and Tim Ryan of the Office of Thrift Supervision, have met with bank and thrift examiners to make sure they know they should not be part of the problem—they have to be part of the solution."

Another proposal under review is designed to encourage bank buyouts, by permitting banks to sell more preferred stock, under the kind of arrangement by which Warren Buffett bought into Salomon, American Express, and Wells Fargo. The result is to dilute bank stock further, and to set up a class of favored stockholders.

All these proposed changes violate the capital adequacy guidelines adopted by the Swiss-based Bank for International Settlements, supposedly as a means of ensuring the safety of international banks. All also anticipate major upcoming liquidity problems for the insolvent U.S. banking system.

The unreality of the administration and the bankers' position was further demonstrated recently by Chase Manhattan Corp. chairman Thomas Labrecque, who admitted that his bank would have third-quarter writeoffs in the same range as the $265 million written off in the second quarter. Despite the fact that this writeoff would be easily an order of magnitude short of what is needed, Labrecque compared his bank to baseball's last-place-to-first Atlanta Braves and boasted: "Chase is back!"

Labrecque's sports analogy is appropriate, in the sense that both the banks and the ballplayers are playing games for public consumption. But baseball is more realistic: If the administration were making the baseball rules, all pitches that were not hit would be defined as balls, and all hits would be ruled home runs.

The deepening depression is beginning to erupt into the nation's political life. Both Senate and House have now passed the agreed-on extension of unemployment benefits. The House, by a margin which is proof against presidential veto, and the Senate, by a majority which leaves Bush two votes over the two-thirds majority required to override a veto. His veto of the extension of unemployment benefits, and of legislation to provide for maternity leave, will come back to tar him with the brush of the Depression President, Herbert Hoover.