Deconstructing the S&L crisis.

THE GREAT BANKS ROBBERY

By James K. Glassman

Vernon, Texas (pop. 12,000), is an oil and cotton center near the Oklahoma border. The hometown S&L, Vernon Savings and Loan, was started in 1960 by R. B. Tanner, a tough old bird who had been a bank examiner during the Depression and knew the importance of making loans to borrowers who would actually repay them. He built Vernon slowly and carefully, and by the end of 1981 his S&L, though fairly small, was probably the soundest in the country, with $82 million in assets and just $90,000 in overdue loans.

As Tanner was building his little thrift, another native of Vernon, a hustler named Don Dixon, was getting rich building Spanish-style houses with signature red tile roofs all over the Dallas suburbs, all the while griping about how lenders kept borrowers like him on a short leash. Dixon decided he too wanted to be a lender, especially after Congress passed a law allowing S&Ls to put loads of high-risk real estate development loans on their books. In 1982 Dixon (who, with his beard, gold chains, and shirt open to the navel, looked a lot like the country singer Kenny Rogers) talked Tanner, then sixty-five, into selling him Vernon Savings and Loan. As James Ring Adams describes it in *The Big Fix*, at the first board meeting after the deal, Dixon asked his directors, including Tanner, to approve the purchase of a $125,000 three-foot-tall bronze sculpture of a squatting Indian for his office. Tanner realized Dixon was not his kind of banker and resigned from the board.

Over the next five years Dixon took in hundreds of millions of dollars in deposits, guaranteed by the Federal Savings and Loan Insurance Corporation (FSLIC), and used the money to make horrendous loans. Under Tanner, Vernon had only 0.1 percent of its loans in default. Federal regulators worry seriously when the proportion reaches 4 percent, and 10 percent generally means insolvency. When Vernon closed its doors on March 20, 1987, some 96 percent of its loans had gone bad. Worse, the S&L had $1.6 billion in assets, so FSLIC had a huge clean-up on its hands. A month later the government filed a civil racketeering suit against Dixon and thirteen of the S&L's officers, claiming they had looted Vernon of more than half a billion dollars. The suit said, among other things, that they had made loans of up to $90 million each to friends without "any reasonable basis for concluding the loans were collectible." In return for booking these bad loans, the S&L's officers were paid more than $22 million in bonuses over four years (Dixon himself got $4.5 million of that), plus $4 million in salary.

Dixon had his wife, her sister, and his stepdaughter on the payroll. According to lawsuits filed by the federal government, Vernon S&L bought a $2 million beach house for Dixon's use in Del Mar, California, and provided another $200,000 to furnish it. Dixon had a fleet of six aircraft at his disposal. During one eighteen-month period he billed Vernon for $561,874 in personal living expenses, including $36,780 for flowers, $37,339 for phone calls, $4,420 for pool service, $386 for pet services, and $44,095 for out-of-pocket incidentals. The Dixons built another house in Rancho Santa Fe, California, and flew to London to consult an interior decorator and buy $489,000 in furnishings.

For his walls, Dixon bought $5.5 million in Western art, also courtesy of the S&L. And since Dixon was a car buff, Vernon set up a subsidiary in La Jolla, California, to sell Ferraris and Rolls Royces. At a 1988 bankruptcy hearing Dixon pleaded that he should be able to keep his personal Vernon-financed car because it had four doors and served as "the family Ferrari." But the peak of Dixonian indulgence was something Don's wife, Dana, called "Gastronomique Fantastique," a two-week tour the Dixons and their friends took in October 1983 of the best restaurants of France, paid for by Vernon Savings and Loan. In a document found by regulators, Dana assiduously recorded the details of every meal. They dined at seven restaurants rated three stars by the *Guide Michelin*, supping on pressed duck, truffle soup, and minced kidneys. "It was truly a dream trip," she wrote, "hardly to be imagined by most, and barely to be believed even by those of us who experienced it first hand . . . a flying house party . . . of pure unadulterated pleasure."

The excesses at Vernon—the risky loans to developer-cronies, the nepotism, and the truffle soup—provide a perfect metaphor for the savings and loan crisis. How did we get here? Through a combination of deregulation, shortsighted home-district politics, changing cultural values, macroeconomics, and the deposit-insurance system. About the first four sources of the crisis, there's not much we can do, but eliminating, or sharply curtailing, deposit insurance is a smart solution.

Usually when businesses do what Vernon and other

S&Ls did, they go broke, bankrupting their owners and leaving suppliers, bank creditors, and sometimes the IRS holding the bag. But the bulk of an S&L's creditors are its depositors, the people who lent their money to it for safekeeping. When it goes broke the depositors aren't left holding the bag because, ever since 1932, the federal government has guaranteed that if an insured S&L can't pay a depositor back, FSLIC (meaning, in effect, the U.S. Treasury) will. So after five years of high living and wild lending at Vernon, FSLIC had to commit $1.3 billion to pay off depositors—more than 200 times what Dixon paid R. B. Tanner to buy the thrift.

Vernon was not an aberration. In the early 1980s developers like Dixon and Charles Keating Jr., men without the slightest bankerly inclination, bought small S&Ls and pumped them up with thousands of government-guaranteed deposits in $100,000 increments. The S&Ls acquired the deposits not from local savers but from rich investors, who shopped the nation for the highest interest rates. Brokers had no need to find well-run S&Ls as havens for their clients' cash, since FSLIC guaranteed all deposits, even in miserable thrifts like Vernon.

Brokered deposits were a grotesque distortion of the original purpose of deposit insurance. In 1932, when FSLIC and the Federal Deposit Insurance Corporation (FDIC) were established, the idea was to encourage small savers to get their cash out from under the mattress and into S&Ls and banks, where the money could be used to invest in homes and businesses. Deposit insurance made sense then because banks were failing at a rapid clip, and runs were common. The guarantees were tailored to the little guy: the limit on insurance was $2,500 per deposit. And S&Ls, in return for using nearly all of their deposits to provide mortgage loans to homebuyers, were allowed to pay slightly higher rates on their deposits than banks.

But in general S&Ls and banks struck the same deal with the feds fifty-eight years ago: the government would insure depositors against loss, and S&Ls and banks would agree to keep enough capital (that is, enough of their own money) in the vaults as a buffer against bad loans and hard times. At the time Franklin D. Roosevelt and the American Bankers Association, among others, anticipated a fundamental problem posed by deposit insurance: it gave savers no incentive to put their money in a sound S&L or bank. In fact, in most cases, depositors are better off choosing a bad S&L—since bad S&Ls, more desperate for funds, usually pay higher interest rates on deposits. In theory, government regulators could put S&Ls and banks out of business if the regulators felt that their loan losses were cutting too deeply into capital reserves, or if they behaved so recklessly that their capital was apt to disappear in the future. Thanks to the niceties of S&L and bank accounting practices, however, a good deal of subjectivity entered into the regulators' decisions. In many cases, it's difficult to say exactly when a loan goes bad.

In addition, powerful political forces mitigated the efforts of regulators blowing the whistle. This country has the most decentralized banking system in the world—more than 16,000 separate institutions, most of which tend to be very influential within their own communities. Members of Congress believe they must pay attention to the needs of the fellow who runs the hometown S&L, who, if he isn't a big contributor, is at least a big local employer and sustainer of small borrowers. So in the 1970s and early 1980s, when S&Ls got into trouble as a result of macroeconomic forces (not, at that point, because of reckless lending or big spending of the Dixonian sort), instead of letting the thrifts with the worst problems fail, Congress and the administration decided to change the rules. Congress was looking out for the interests of powerful home-district S&Ls while the Reaganites were following their deregulation agenda.

The theme of the new deregulatory laws, passed in 1980 and 1982, was that S&Ls should be allowed to grow their way back to health by making new, far riskier investments—like land-acquisition and construction loans to commercial real estate developers, junk bonds, and Ferrari dealerships. As a result, instead of a few dozen badly managed, or unlucky, thrifts going out of business at a cost to the taxpayers of $20 billion or $30 billion, we're now faced with more than 1,000 failing at a cost ten to twenty times as high.

But the S&L mess is also the result of a major cultural event: the disappearance in American life of the stigma against borrowing. In the 1980s, the go-go years of Reaganism, debt continued to create anxiety, but not in the old way. You no longer worried about whether you could pay back the loan, but whether you had borrowed enough to enjoy the good things in life before it was too late (meaning before someone cut off your line of credit). Debt allowed new heroes like Donald Trump, Ron Perelman, and Carl Icahn to acquire great American institutions, icons like the Plaza Hotel, Revlon, and TWA. The more speculative the venture, the more alluring. Few borrowers had experienced the Great Depression, and they vaguely sensed that, whatever happened, they would be bailed out like Chrysler and Lockheed. No one went flat broke in America, at least no one who started with something. Borrowing was where the tax deductions were, and it would let you buy a house in Mamaroneck for $3,000 a month or a BMW for $600.

Swept up in a competitive frenzy, bankers, who used to hem and haw while supplicants knelt to ask for money, started stuffing the dough into the pockets of anyone who would take it. In the past there was a dynamic at work in which lenders, in their reluctance to lend, would transfer a burden of guilt to borrowers: "Here's the money, my friend. But make sure you return it in the condition you received it." The dynamic disappeared when the lenders made it clear that the borrowers were doing them a favor: "Please," said a piece of junk mail I received a few years ago, "accept this line of credit, up to $10,000, to use as you wish." They didn't even seem to care if you gave it back. The great old white-shoe banker, George Moore, former chairman of Citibank, wrote in his memoirs: "If you let the credit men, the analysts, run the bank, you won't have any customers; if you let the salesmen run the bank, you go bankrupt." In the '80s, S&Ls let the salesmen run the bank.

The roots of this cultural change go deep. In the boom years after World War II the thrift business had been an easy game. You took in deposits at between 4 and 5 percent, thanks to interest ceilings, and lent it out at between 6 and 8 percent. Then, in the late '60s and '70s, several events conspired to raise banks' borrowing costs. The first was the Vietnam War (plus the War on Poverty), which Presidents Johnson and Nixon decided to finance with government bonds instead of taxes. With the government a more prominent issuer of debt, interest rates rose, as they always do when the competition for investors' funds increases. Then, after the Arab oil embargo of 1973, there was inflation. Saving became a game for suckers. If you put your money in a passbook account, you'd earn 5 percent; with inflation running 10 percent, the value of your principal was being whittled away. So Americans started taking money out of banks and spending it—buying things before their prices rose some more, in the process pushing inflation even higher.

Then it got worse. Some depositors were taking their money out of S&Ls and banks and putting it into investments, like money market funds (invented in 1972), that earned higher rates of return. Finally, in 1980, with the strong backing of the White House, Congress passed the Depository Institutions Deregulatory Act, based on the noble sentiment that "all depositors, and particularly those with modest savings, are entitled to receive a market return on their savings." In fact, the purpose of the law was to stop banks and thrifts from bleeding to death. It raised the limit on federal insurance from $40,000 to $100,000 per account (the figure had been as low as $10,000 as recently as 1950), and it phased out interest-rate ceilings over a six-year period, ending in 1986. Banks and S&Ls now could offer higher interest to depositors and get the money to keep operating, but the cost of deposits—the cost of a bank's own borrowing—soared. In the mid-'70s, it was not unusual for a bank to pay no interest at all on most of its deposits. The S&Ls, by tradition, had been lending long (thirty-year home mortgages) and borrowing short (passbook savings accounts, which could be withdrawn on short notice). In 1981, most S&Ls were suffering "negative spreads" on their mortgages, not even counting overhead costs. So, as the old joke goes, they tried to make it up on volume.

Having solved the liquidity crisis (thrifts running out of money), Congress was faced with a profitability crisis (thrifts stuck with long-term loans that weren't paying enough interest to cover the cost of short-term deposits). Again, the proper response would have been to let the regulators shut down S&Ls whose capital was depleted; the insurance bill would have been fairly low, and a stronger generation of thrifts would have emerged.

Instead Congress, again with the strong support of the White House, decided to let S&Ls go into entirely new businesses: instead of forcing them to make loans only to people buying homes, let them lend to developers with big dreams. Or let them use their deposits to buy assets that get even better returns than conventional loans, like Michael Milken's junk bonds or what regulators euphemistically called "direct investments" (equity interests in hotels and shopping centers). In 1982, in the face of 250 S&L failures, Congress passed a bill sponsored by Senator Jake Garn, a Utah Republican who then headed the Senate Banking Committee, and Representative Fernand St Germain, a Rhode Island Democrat who chaired the House Banking Committee. The Garn-St Germain bill had such overwhelming support that it was approved without a recorded vote. It liberated the thrifts and then murdered them.

Most of the executioners showed up promptly after the bill sailed through. Like Don Dixon, they were wheeler-dealer real estate operators, who saw S&Ls as a source of unlimited funds (those guaranteed deposits) for their own ventures and those of their pals. Real estate was hot at the time, thanks to tax-law changes that allowed owners to depreciate their properties quickly, generating big up-front tax losses. Only circumspect lenders stood in the way of enormous profits, so, the developer figured, why shouldn't I become a lender myself? Regulators say there is a pattern among failed thrifts: a change of ownership between 1982 and 1984 (with the buyer often a developer or someone fronting for a developer) and spectacularly fast growth in assets—mostly real estate loans supported by lots of $100,000 brokered deposits.

With the hustlers coming out of the woodwork, many of the smart old-line bankers figured that this was a terrific opportunity to bail out of what they correctly saw as an increasingly difficult business. Thus in 1983 Don Crocker sold his California thrift, the small and mildly profitable Lincoln Savings and Loan, to Charles Keating, an Arizona homebuilder with a shady past. With help from Milken and his crew from the Beverly Hills office of Drexel Burnham Lambert, Keating bought Lincoln for $51 million, an astronomical price, nearly twice the thrift's net worth and three times what Lincoln's stock was fetching on the open market. To Keating it seemed worth it. He saw Lincoln as the perfect vehicle to enhance his personal wealth and prestige—and for a time, he was right.

Like Dixon, Keating pumped up his S&L using brokered money. In five years it grew sixfold, to $5.5 billion in deposits. And Lincoln pulled out of the traditional business of S&Ls almost entirely. Lending to homebuyers represented less than 2 percent of Lincoln's business. Meanwhile investments in junk bonds—high-interest debt issued by corporations, usually in conjunction with a leveraged buyout—went from zero to $779 million. As usual, Milken benefited from the leverage: he helped Keating buy a $51 million thrift and then sold him junk bonds costing fifteen times the purchase price, thus reaping huge fees. Milken would repeat this little trick several times with other S&Ls, and they too would find when the debt bubble burst in 1989 that junk bonds were not particularly profitable.

Thanks to Garn-St Germain, Keating and Milken and dozens of other operators were able to give a whole new meaning to thrifts. They became a way to help corporate raiders buy established companies, for speculators to build monuments to themselves (like Keating's Phoenician resort, probably the most spectacular hotel bust of all time), and for new thrift operators to get rich using other people's money. Keating, for example, hired his son as a senior officer at the age of twenty-six, a meteoric rise from busboy and waiter at a country club.

Keating, Dixon, and other S&L operators understood the importance of political connections. Stephen Pizzo, Mary Fricker, and Paul Muolo point out in *Inside Job* that Dixon had a yacht, the 112-foot *High Spirits*, which was anchored on the Potomac and used by House Majority Whip Tony Coelho for eleven fund-raising parties for the Democratic Congressional Campaign Committee in 1985 and 1986. The cost to the DCCC for those parties was zero; cost to Vernon S&L, $48,450. (After bank examiners discovered the set-up, the DCCC dutifully repaid Vernon.)

In late 1986 regulators finally understood what was happening at Vernon (which they affectionately called "Vermin"), declared its loans in default, and pegged its net worth at minus $350 million. As John Barry describes it in *The Ambition and the Power*, with time running out, Dixon turned to Coelho, who in turn contacted Majority Leader Jim Wright, who in another week would become Speaker of the House. Dixon told Wright that the regulators were trying to put him out of business immediately, but if he had a week or so he could work out a sale. Over Christmas Wright called Edwin Gray, the chairman of the Federal Home Loan Bank Board and the chief S&L regulator, and told him, "Ed, I don't know anything about Vernon Savings and Loan or Don Dixon. . . . But he tells me he's got a buyer and needs one week to dispose of his business himself, and he says regulators want to close him down today. I wonder if you could look into it." The Speaker's intervention was too late. Regulators put Dixon out of business the very day of the phone call.

Keating's variation on the theme has received broader notice. He tried to keep regulators off his back by orchestrating donations to the campaign treasuries and political committees of twenty-four members of Congress, including five senators—Republican John McCain of Arizona and Democrats Alan Cranston of California, Dennis DeConcini of Arizona, John Glenn of Ohio, and Don Riegle of Michigan, the chairman of the Senate Banking Committee. The five put pressure on Gray and other top officials to keep Lincoln open in 1987, and it was not until 1989 that a regulator discovered that its net worth was minus $948 million and getting worse. It will cost at least $2 billion to clean up the mess, and the U.S. and California eventually filed civil and criminal charges against Keating and his associates. The Keating Five are currently being investigated by the Senate Ethics Committee.

But it wasn't their relationship with politicians that helped Keating, Dixon, and other S&L owners elude regulators; it was the nature of bank accounting, coupled with that inexhaustible supply of brokered, insured deposits. Many of the S&Ls that crashed used these two clever techniques: 1. Capitalized interest. A developer comes to an S&L with an idea for a speculative venture that will cost, say, $50 million. The S&L lends him the $50 million, plus legal and other "soft costs" (another $2 million or so), plus four "points" (the S&L's own fee for setting up the loan), plus interest at, for example, 14 percent for two years ($14 million). That comes to $68 million, up front. (Imagine buying your house with a loan from the bank covering 100 percent of the principal, all the closing costs, and interest for two years.) The S&L, under accounting rules, can book the points as profit for itself immediately, and it can book the interest at a rate of $7 million a year. So in the first year the S&L records $9 million in income, even though none of the $9 million came from the developer. It all came from the S&L itself. You can see where this sort of thing can lead—a $68 million loan for a $50 million project (and usually a risky one, at that) can go bad in a hurry. But since the developer doesn't have to pay interest out of his pocket for two years, the regulators can't tell whether the loan is in default until it's far too late. Even then, S&Ls would hide such loans by selling them to each other at inflated prices in a daisy-chain network.

2. Land flips. The idea here, perfected by Empire Savings and Loan Association of Mesquite, Texas, was to buy and sell vacant land, with the help of sleazy cohorts, sometimes turning the property over several times a day at higher and higher prices. The value of the land, on paper, would soar, and with the help of other S&Ls that were in on the deal and of compliant and negligent private appraisers, the property could end up trading hands for ten times its original price. (The Government Operations Committee cited one example in which a 3.6-acre piece of land was bought for $156,816 and eventually sold three months later for $1,724,976 with a loan from Empire of $1,879,250.) Doing the lending along the way, Empire would pick up points, between 6 and 18 percent of the purchase price, and book them as profit. The money for buying the land came from brokered deposits; eventually 85 percent of Empire's deposits, which grew from $17 million in 1982 to $309 million in 1984, came through brokers. The flips also inflated the asset side of Empire's balance sheet, making it the fastest-growing S&L in America.

The loans usually matured in six months to a year. Then Empire would come in with a construction loan that would repay the previous debt and cover closing costs, building costs, fees for the S&L, interest, and even the expenses in promoting the condos that would eventually (maybe) be built on the land. After two years of glory, Empire was shut down in 1984 at an ultimate cost to FSLIC of $163.8 million, at the time the biggest payoff in the insurance agency's fifty-year history. It would later seem a pittance.

It's important to understand that the money that Empire and the other go-go S&Ls lent out did not disappear off the face of the earth. It went to developers, who rented bulldozers and bought sheetrock and Porsches, and eventually went broke. The money helped fuel a boom in the West at a time when oil prices were falling. The problem today is that the money is already spent. The developers can't pay back the S&Ls, and the S&Ls can't pay back the savers, so the federal government has to step in. The government has been loath to do so, for two reasons: first, it means shutting down S&Ls owned by politically connected people, and, second, it means shelling out a lot of cash, which the government doesn't have.

In February 1986 the General Accounting Office estimated that FSLIC needed $22.5 billion in new capital so that it could shut down failing thrifts and pay their depositors. The administration asked for $15 billion, with the money coming from S&L insurance premiums rather than tax dollars. But the bill was held up in Congress for months, by Wright and others. The bill returned in the spring of 1987, and again House members opposed it. Finally, on July 29, 1987, a year and a half after the GAO report, Congress passed a compromise, giving FSLIC $10.8 billion—far too little, far too late.

So the next year FSLIC came up with a new solution: to "sell" failing thrifts to rich buyers for practically no money; to give these buyers, including billionaires like Ron Perelman and Robert Bass, big tax breaks; and then to guarantee their S&Ls against losses down the road (using money that FSLIC figured Congress would appropriate after the presidential election). FSLIC and the Federal Home Loan Bank Board, which regulates S&Ls, desperate to unload the thrifts, started making quick and dirty deals. These deals either went sour, leaving the taxpayer to clean up the mess, or ended up making their new owners millions. (See "Everything Must Go," TNR, October 10, 1988.) For an investment of $171 million, for example, Perelman earned more than $250 million in tax benefits and profits the first year. Just last month a congressional review found that the sale of 100 of these thrifts in 1988 will cost the taxpayers $71 billion.

By 1989 all of these scams and dilatory tactics had run their course, and Congress had to accept the task of putting up cash to shut down S&Ls and pay off deposits. But calling on taxpayers to foot the bill directly would cause political problems, so the Treasury floated thirty- and forty-year bonds to raise the first chunk of bailout money. The main effect of these bonds—and the ones that will certainly follow—has been to increase competition for the limited funds of investors and thus raise interest rates for all of us. Forget all that talk of a $2,500 bill coming to each taxpayer for his or her share of the S&L bailout. The cost is more insidious, showing up in mortgage rates and interest on installment loans and increased costs for businesses that want to expand.

There's a second effect: throughout most of the '80s S&Ls did spread cash around, especially to commercial real estate developers. As a result, the centers of many American cities became overbuilt with office towers and the suburbs overbuilt with garden apartments and condos. This overbuilding has contributed to our current real estate slump and to severe losses for more traditional commercial lenders, the banks. The banks, in turn, have tightened up their lending policies, partly because their capital is being depleted by bad loans and partly because they fear the wrath of regulators who don't want to be blamed for another S&L disaster. So now, even good credit risks can't get loans, slowing down business in general and creating, at best, regional recessions.

There's certainly enough blame to go around in the S&L scandal: to Congress, for writing new laws, pressuring regulators, and starving FSLIC to keep insolvent thrifts alive; to the White House, for mindlessly pushing deregulation on an industry that wasn't ready for it and for doing its best to hold down the number of bank examiners; to the greedy, shortsighted industry itself; and, of course, to S&L operators, many of whom will be spending their retirement years in prison. But the culprit that's most productive to address is the policy of insuring deposits in S&Ls with the full faith and credit of the federal government.

The government simply can't continue to insure every account in each of this country's banks and S&Ls. It doesn't have the money. In fact, the great untold scandal is that ever since the failure of Continental Illinois Bank in 1982, federal insurance has covered *all* accounts—even those greater than $100,000. Today such deposits total $3 trillion, and the FDIC (which, in the 1989 S&L reform bill, swallowed up FSLIC) has assets totaling no more than one-half of 1 percent of that amount. What needs to be done immediately is to abandon the current policy and replace it with a limited insurance system. Federal deposit insurance should cover no more than, say, $50,000 per depositor—instead of $100,000 per account. I consider that an intermediate step on the way to phasing out deposit insurance altogether within two years. If small savers want total protection, they should put their money in U.S. Treasury securities, or into money market funds that invest only in federal bonds. The latter is a very simple alternative that didn't exist when FSLIC was founded. (See "When Hell Sleazes Over," TNR, March 20, 1989.)

Without federal insurance, depositors would demand that a reckless S&L pay them very high interest rates, or they would refuse to deposit their funds there. It's true that most people today aren't able to judge whether an S&L "deserves" their deposits, but they would learn very quickly, just as they've learned which cars are the safest and which stereo speakers produce the best sound. And consumers will have one obvious clue: an S&L that offers to pay high interest rates will almost always be a riskier bet for a depositor, just as a corporation that's forced to pay higher interest on its bonds is riskier. If there's still concern about the little guy, here's a simple solution: make deposit insurance a means-tested entitlement. It would be available only, for instance, to families whose income is less than $40,000 a year. Let the rich fend for themselves.

Finally, I am not advocating more deregulation. Federal regulators should still play a role in assuring the stability of individual banks and S&Ls, in much the same way that the FDA and FTC stand watch over the quality of consumer products. We should retain strict capital requirements and toughen accounting rules. But deposit insurance, which gives reckless banks, in effect, a direct pipeline to the U.S. Treasury to meet their operating expenses, must go.

Although a limited-insurance system wouldn't prevent unscrupulous bankers from making bad loans, it would prevent them from using federally backed money to grow their way out of their problems. It would also end one of the more egregious examples of state capitalism's tendency to privatize profits and socialize losses. The frightening truth is that there is no more discipline over S&Ls today than there was at the start of the '80s. Congress and the White House have been too busy pointing fingers to find a solution, and Federal Reserve Board chairman Alan Greenspan says he's waiting for a report from the Treasury on deposit insurance. So far that report is eighteen months in the making, and I don't have high hopes for it.

Unfortunately deposit insurance is an idea with a lot of political force behind it. Liberal politicians like it because it has a generous, populist quality, and conservative apologists for financial interests like it because it has the effect of lowering the interest rates that banks and S&Ls have to pay on their deposits. And a specious argument left over from the panic years of the '30s continues to have appeal—the notion that without deposit insurance, there would be uncontrollable "runs" on banks. In fact, spontaneous mass withdrawals are a rarity. Consider, for instance, money-market funds; they're uninsured by the federal government, yet they've never been hit with runs. More frequently, when investors grow suspicious of the stability of a financial institution, they pull their money out slowly, over time. And even if a run does occur, the Fed can always open its "discount window" to the target of withdrawals, providing unlimited funds on an emergency basis, in the same way it stood by to help brokerage firms when the stock market plummeted in October 1987.

Abolishing deposit insurance is not a totally riskless solution to the S&L crisis, but it is the only step that will keep people like Don Dixon and Charles Keating out of the banking business. If the government continues to insure the deposits of poorly run institutions, allowing gamblers to double their debts at the roulette table, it will ensure something else: a financial disaster that will make this one look tame. •