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# The Savings and Loan Bailout: A Simple Economics Lesson

by Representative Bernie Sanders, I-Vt.

The federal government bailed out the Savings and Loan banks to the tune of tens of billions of dollars, and less than a year later the government had to add more tens of billions to bail the banks out some more. The cost of the bailout is now at some 50 billion dollars. Billion! Now President Bush is asking for yet more tens of billions to bail out the savings and loans once again. What's going on?

I sit on the House Banking Committee. If you listen to what they say in Washington, the situation is complicated. You know how economists talk: they use words and phrases that normal people can't understand, and after they are done talking they finally say one thing you **do** understand. They hand you a bill, and tell you how much the government is going to have to pay.

Well I'm not professor of economics, and I haven't been around Washington for a long time. That qualifies me as someone who can talk straight with you about what is going on with the Savings and Loan crisis.

How did we get into a crisis? Let me explain with a simple story. Imagine that someone you went to high school with moved down to Texas and, in looking for a job, found work as a teller in a bank. After ten years, he somehow managed to become President of the bank.

So one day he is sitting in his office and a man walks in and says he wants a loan. The man is very tanned--he obviously spends a lot of time at beach resorts--and he has lots of gold necklaces and bracelets adorning his person. He says that he wants to build a large condominium vacation-home complex, which he will develop on some desert land his brother-in-law owns. All he needs is 150 million dollars to finance construction of Tumbleweed Acres.

Your friend the president asks what he will put up as collateral. "Oh, you can have the land and a first mortgage on the condominiums as collateral." Your friend frowns a little. "I'm so anxious to get money that I'll pay you interest at a rate of 3% above the prime rate." Your friend smiles: the sotckholders will be pleased with these big profits. He approves the loan.

The next day a man and a woman, both dressed in very stylish but conservative business suits, fly in from New York to visit your friends. It seems that the management of the Buggy-Whip Company wants to buy up the company from its stockholders. In order to get the cash to buy up the stock, they are selling bonds which promise a very high rate of interest. Your friend asks how the bonds are secured, but instead of answering him directly the two bond-brokers give a long speech about how the bonds pay high, and they mean really high, interest. So your friend takes 100 million dollars worth of these bonds for the bank, paying out depositor's hard-earned cash for them.

A year later, just as your friend the bank president has his feet up on the desk in his cowboy boots and is reading in the newspaper that the stock market is on a two-week downturn, he gets a phone call. The man with the gold jewelry is on the line. He says that Tumbleweed Acres has only managed to sell twenty of five thousand condos. The money realized from that sale has gone to pay off his brother-in-law and to pay his own salary and bonuses. The condo company is bankrupt, and he is calling to tell the bank that, instead of paying back the loan, he is turning the condos over to the bank. Oh, one problem. Because the money ran out, there is no plumbing in the condos, and because they couldn't pay the supplier the windows and doors as well as the stoves and refrigerators never arrived for four hundred of the condos.

No sooner has your friend hung up the phone than there is another caller. Sales of buggy whips have been very slow--it is a bad season, it seems, for buggy whips--and the Buggy-Whip Company has gone bankrupt. The bonds the bank held are not trading any more--no one will buy them. But don't worry, the bond-broker says: in return for your investment of 100 million dollars, the firm is sending its entire stock of buggy whips to the bank. They will arrive tomorrow, five truckloads. You'll only have to pay the trucking costs.

Meanwhile, some nice old ladies come into the bank and try to withdraw some of the money they deposited when their social security checks arrived. They need to pay the rent on their apartments. But the bank has no money to give them: all their money, and that of the other depositors, has been lent out to Tumbleweed Acres and Buggy-Whip Company. Up till now, the bank had been using the interest on the loans to pay depositor's needs for money. But now there is no more interest, and no more principal. The bank is broke. It has no money.

So the bank goes bankrupt. And the Federal Savings and Loan Insurance Company steps in. Through that agency the government has promised to insure that every deposit is safe, so the FSLIC will give the old ladies their money, and the local grocer the money he had deposited, and the families the money they had been saving to send their children to college.

But where does the FSLIC get its money?

Well, there was originally a reasonable amount of money in the fund because banks were charged modest premiums for this banking 'insurance.' But there wasn't enough money to underwrite all the stupid investments made by bank managers as greedy and unwise as your friend.

So the government--this is the great George Bush plan--turns to the old ladies and the grocers and the hard-working families of America, and says "If you want your money to be safe when it is in a bank, you will have to pay a lot more in taxes--at least a thousand dollars a person, maybe even a lot more--to help out the banks."

Now I ask you, is that fair? Does that sound sensible?

What about the man with the gold jewelry, what does he pay? He is off in the Bahamas in a luxurious home with a pool, sitting on the beach working on his tan. What about the bond-brokers who are off skiing from at their luxurious condo in Aspen? What about the ex-President of the Buggy-Whip Company, who sold his stock to himself and pocketed the bank's money so that he could buy a Mercedes for each of his seventeen grandchildren? And what about your friend the bank president, who doesn't mind the bank's failure and his loss of a job because he had saved up much of his $250,000 annual salary and now has a job teaching economics at a local university?

Why don't these people pay?

Why don't they bail out the banks? They're the ones who made the profits. They're the ones whose greed led them to make stupid business decisions.

What has happened to that old American notion of responsibility? Don't the people who make the mess have an obligation to clean it up?

Not according the George Bush. He wants you to believe that bank failures are your problems, and that you, the hard-working people of America, should give up adequate health care, a decent education for your children, safe highway bridges, building low-cost housing--that you should give up all these things so that the bankers and investment brokers and real estate speculators will not have to pay the bill for the mess they created.

Well I don't buy Bush's plan. As a member of the House Banking Committee, I have pledged not to vote for any further bailout of the banks unless the President tells us where--from whom--he will get the money.

And if he won't ask the rich and the super-rich to pay for the bailout, he won't get the money. Let those who profited pay part of their profits to cover the losses their financial shenanigans have created.

There. The economics lesson is over. I don't know why economists and politicians always pretend it is such a mysterious science. Economics isn't so tough if you think straight. Every normal American knows that if you spend more than you bring in, your family won't be able to pay its bills, and that if you risk your bread money on a Las Vegas crapshoot, you are likely to go without bread tomorrow.

Which makes every normal American a lot smarter than most of America's bank presidents.

So why should the smart hard-working folks of America have to bail out the rich dumb folks for their stupidity?

Because the rich dumb folks think we are even dumber than they are. But we aren't dumb, and we aren't going to pay.