FDIC Speeches

Restructuring the Polish financial system

Remarks by

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Comments on the Current Financial Scene

Good morning ladies and gentlemen. I am pleased to have this opportunity to address CUNA's Governmental Affairs Conference and I promise to keep my remarks brief this morning.

Just a few minutes ago before I came out, I had the great pleasure to meet your guest from the Solidarity Party in Poland, Mr. Adam Jedlinski.

I'm sorry Mr. Lech Kaczynski was unable to be here today. I hope after a speedy recovery, he will be joining us in Washington.

As I understand it, these gentlemen have asked the Credit Union National Association for advice on how to restructure the Polish financial system. The fact that they have asked you for advice increases my optimism for their future success immeasurably. The fact that they did not ask me for advice increases it even more.

But, you know, I can't help thinking what I might tell them if they <u>had</u> come to me for advice. I'm not sure I could tell them what to do-- but, given my experience with the U.S. financial industry over the last couple of years, I think maybe I could tell them what <u>not</u> to do.

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First off, I think I would tell them that as they explore the advantages of a free market, not to abandon all governmental control of their financial system. The truth is--no free market ever worked without government regulation.

Our current problems with the savings and loan industry are in large measure a result of too little supervision.

For all the right reasons, but with too little fore-thought, we deregulated the savings and loan industry. We allowed the thrifts to act like they were using their own money.

Unfortunately, we neglected to provide for the supervision of thrifts that reflected the fact that 97% of the money was government insured deposits.

Consequently, some inexperienced people made a lot of bad decisions and some fraudulent operations seized the chance to steal us blind.

I hope that we have learned a lesson from this costly mistake that we will not forget, and our friends will find instructive.

Next, I think I would tell our friends not to set up a system that favors debt financing over capital formation.

One of the most disturbing developments in the U.S. economy is the high level of debt held by individuals, corporations, and governmental entities. Since 1965, the total debt of the domestic, non-financial sector has increased almost tenfold.

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This tremendous amount of debt is a danger to our financial system.

There is probably no private sector area where this debt phenomenon has raised more concerns than in the use of highly leveraged transactions or Leveraged Buy Outs.

Did you know that the total value of the LBO's completed in 1988 alone accounted for $77 billion. Regulators, Congress, and the media have all highlighted this problem and searched for solutions.

I would tell Mr. Kaczynski and Mr. Jedlinski to adopt a system that discourages this kind of favoritism for debt. One way they might do this is to set up their tax system so that it gives equity financing the same priority as debt financing. In our system, interest on debt paid by corporations is tax deductible, dividends paid to shareholders are not. In effect, our system rewards corporate debtors by making it cheaper, "tax-wise," to raise money by borrowing rather than by selling stock.

Don't do it this way! I would tell our foreign friends.

I have some ideas on how we could change our own tax system so that it wouldn't favor the debtor. My view is we ought to treat dividends and interest alike -- <u>and</u> in the same way we treat salaries. We all know how salaries are treated. The employer withholds the tax from us wage-earners. We then use that with-held tax (as shown on our W-2 form) to pay our obligations April 15.

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I think we could treat dividends and interest payments the same way. That is to say, make them both tax deductible to the corporation and subject to with-holding for the benefit of the investor. But, I'll have more to say about this idea one of these days soon.

There is another thing I would tell your friends-- I would tell them to treat government guarantees like poison.

Now, they might think this was pretty strange advice coming from the Chairman of the Federal Deposit Insurance Corporation. But then remember, we (as the Resolution Trust Corporation) have been assigned the task of cleaning up the S&L mess. A mess caused by government guarantees out of control.

In fact, let me tell you what that situation looks like today.

As of January 16, 1990, the RTC had resolved 40 institutions. It had 293 institutions under conservatorship. These 333 institutions held $136 billion in gross assets and $148 billion in liabilities as of September 30 of last year. Our estimate of the cost of resolving these institutions is approximately $42 billion. Now that's just today's menu--what about tomorrow?

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A preliminary estimate given to the RTC by the Office of Thrift Supervision on January 18, indicates there are 225 to 295 institutions with $160 billion to $200 billion in assets, above those already under RTC conservatorship, that can be considered "likely to fail."

That preliminary estimate also identifies an additional 295 to 325 undercapitalized institutions with $185 billion to $205 billion in assets categorized as "distressed"--maybe they will fail, maybe they won't.

The estimated loss today might be about 20 percent of the gross assets of the institutions that do actually fail. However changed conditions can change that estimate either way.

As a further result of the S&L mess, the RTC has assumed the litigation responsibility for over 40,000 lawsuits. In fact, we expect to end the year with double that amount. We may even create a shortage of lawyers.

However, if our friends from Solidarity chose to ignore my advice and insist on setting up a deposit insurance system-- then I hope they wont allow the participating institutions to treat premium payments as assets on the books. But, perhaps I should save that issue for another group.

I would also tell our friends not to panic at the first hint of a recession. Free markets have recessions--it's a fact of economic life.

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As a matter of fact, I have been getting a lot of questions about our own economic health in light of our recent experience with the real estate markets and the Resolution Trust Corporation (which incidently, along with the FDIC has over $30 billion worth of real estate to sell.)

Contrary to some opinions, I am not the Cassandra of real estate forecasting. It is true, the real estate market is soft in some areas of the country, particularly in the southwest and the northeast. But, it's an ill wind that blows no good.

Frankly, I would view the situation as an investment opportunity. It's a time for savvy investors to pick up some very good deals.

Perhaps your friends from Poland might like to buy an office building in Dallas?

I would also remind our friends to cherish their middle class and never to let the disparity between rich and poor become too great. One of the great strengths of America is that the majority of its citizens see themselves as members of the middle class.

Credit unions have long known this fact and through their service to their communities they have inspired and strengthened working Americans everywhere.

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Let me just add that credit unions are doing well as a result of their fine service to the community. I hope you will not forget that fast growth, new and unfamiliar business as well as poor supervision at the S&L's was the cause of their demise.

I hope you will have the wisdom to avoid their temptations and to stay with your traditional lending strengths.

There is one last thing I would tell your friends. It's the same thing I regularly tell myself--and that is to guard your political freedom as if it were your life savings. In reality, that's exactly what it is. Economic freedom depends on political freedom and vice versa. No one has ever found a way to have one without the other.

That's about all the advice I have to give. I'm sure I've left out a lot of important things. But, as I often tell my children--I'm not young enough to know everything.

It's been a great pleasure being with you today. There is one thing I can guarantee your friends from Poland --by coming to the Credit Union National Association, they are certain to find good friends and good advice.

Thank you.

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