AFTER THE SUMMIT
An Exclusive Interview With Bush

Newsweek

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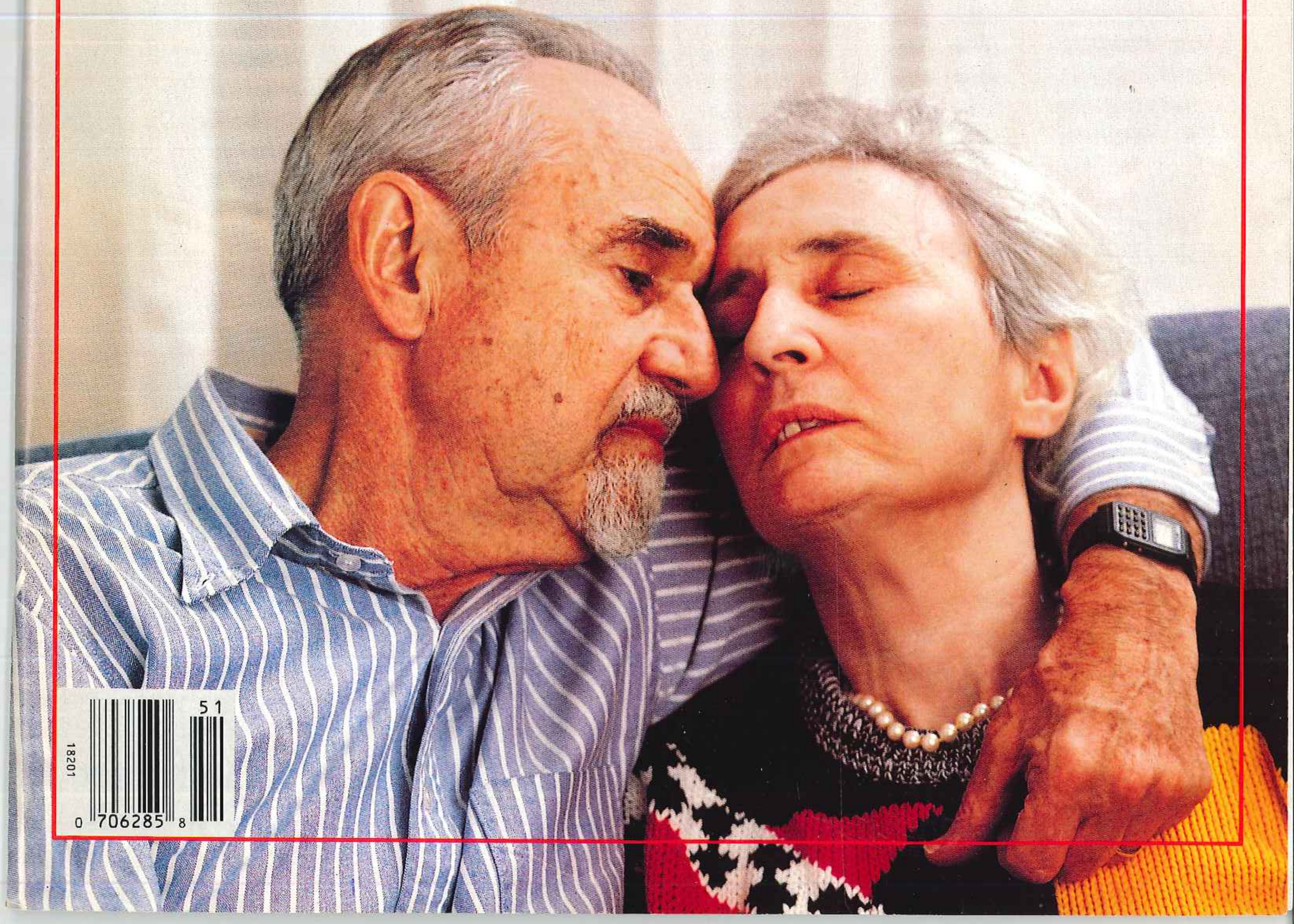
All About Alzheimer's

What Doctors Know ■ How Families Cope



TOM SOBOLIK—BLACK STAR

Help for people in flood-prone areas: *Charleston in the aftermath of Hurricane Hugo*

The $5 Trillion Shock

Are government-guaranteed loans the next crisis?

The $5,600 tuition is a bit steep for the mostly low-income students at Debbie's School of Beauty Culture in Chicago, but in one year they can learn hairstyling, manicuring and "skin-care artistry." And as ads for the school point out, federal financial aid is available. As it happens, about half the students quit before the year is out and at most Debbie's franchises over 70 percent default on the loans, more than double the average for trade schools, according to the U.S. Department of Education. Debbie's officials say the rate is high because they train many low-income students who live "in a dropout society."

Why do such high default rates persist? Education Department officials believe that some schools coax in students with little concern for whether they finish the program or can repay a heavy debt. The school has little incentive to keep students from dropping out: it pockets the tuition check either way. Debbie's argues that it shouldn't be blamed because banks lend to students who, statistically speaking, are almost certain to renege. Why aren't the banks more careful? Because when the loan goes bad the tab is picked up by a nonprofit "guarantee agency." And these agencies don't always aggressively weed out banks with bad records because—follow the bouncing bailout—most of their losses are scooped up by the federal government through a loan-guarantee program.

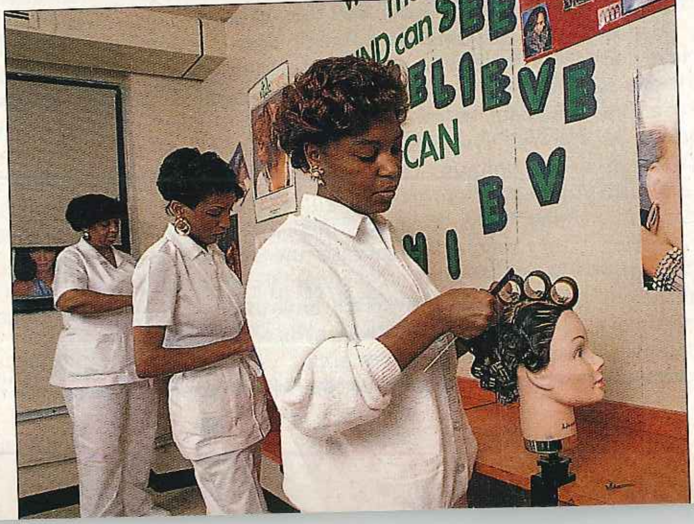
The federal government is now responsible for more than $5 *trillion* in other people's bills through programs like the one that financed Debbie's dropouts. Not all government-backed loans will go bad, but the General Accounting Office recently startled Congress by predicting it would have to absorb $100 billion to $150 billion in losses on loans already considered uncollectible. That's on top of the $120 billion savings and loan bailout. In total, the government's liability is 10 times what it was 20 years ago. Through loans, loan guarantees and insurance programs, the government now indirectly backs everything from private corporate pensions to a homeowner with a flood-prone house. The new numbers have prompted Congress and the Bush administration to pledge reform early next year. Without action, says GAO official Donald Chafin, the losses "are just going up like a rocket."

Ironically, the problem grew out of Congress's determination not to spend money. Or at least a desire to look as if it wasn't. The government has been giving grants or direct loans for years, but starting in the late 1970s and 1980s, budget deficits made that politically difficult. So Congress and the federal agencies started awarding loan guarantees and insurance instead; that way, the government would pay only if the loan went bad or a disaster forced an individual to claim the insurance coverage. It was considered more cost effective than funding everything through congressional appropriations since the programs attracted private-sector money. Best of all, it was politically painless because the government's cost would not be visible until years later. "Whenever people sit down together and say, 'Let's do a new program,' someone says, 'There's no money'," says Rep. Charles Schumer. "Then someone else says, 'Well, how about loan guarantees?' "

More than half the loan guarantees were signed in the last 10 years. For example, the government began emphasizing student-aid loans rather than giving out grants. The result: default costs have jumped from $235 million in 1981 to an estimated $2 billion this year. The Farmers Home Administration continues to write billions in new loan guarantees each year even though it is now writing off $22 billion in bad debt from past loans. That follows a $4 billion bailout of the government-guaranteed Farm Credit System, another agriculture program. At the Department of

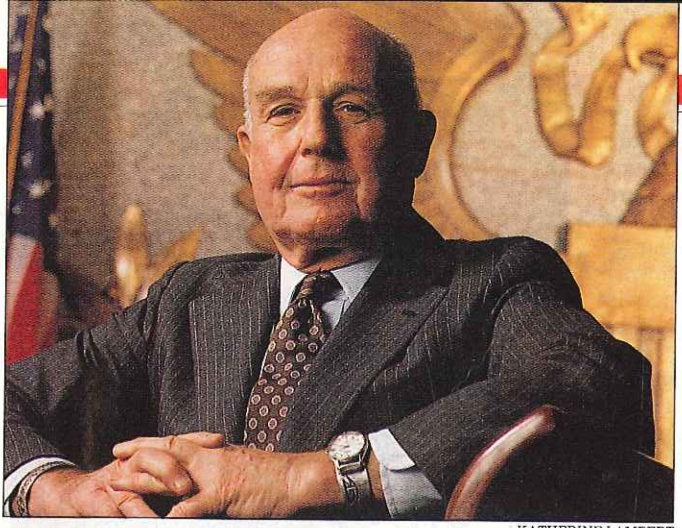
Follow the bouncing bailout: *Debbie's School of Beauty Culture*

DAVID WALBERG



Housing and Urban Development, three government agencies have just swallowed $13 billion in bad housing loans.

Cosigning someone else's loan is known as "suicide by fountain pen" when done in private business. Government agencies "collect from bozos like this all the time," says William Seidman, chairman of the Federal Deposit Insurance Corporation, which picks up the pieces for failed banks and savings and loans. "The guy says, 'Geez, all I did was sign a note for my buddy. I never dreamed he wouldn't pay'." The problem is the same for government: if the people making the loan don't bear the risk, they will be less careful. Evidence can be found in a dusty lot just off South Main Street in Lexington, N.C., the resting place for hundreds of abandoned mobile homes. These trailers, some stripped of everything from their fake wood paneling to the kitchen sink, were made, sold and financed by the Conner Corp., a mobile-home company based in Newport, N.C. Its owner, Wallace Conner, bought a local savings and loan in 1984, which former state regulator George King says in retrospect "was like throwing Br'er Rabbit in the briar patch." Conner was then able to raise money from depositors (who knew their money was federally insured) to pay for risky mobile-home loans. If the housing loans went bad, several federal loan-guarantee programs would rescue the investments. Conner offered $20,000 trailers for as little as $295 down to people who, it turned out, couldn't really afford them. When the economy turned sour and the poorer owners couldn't pay, the government was stuck with a $230 million bill.



KATHERINE LAMBERT

Picking up the pieces for banks and S&Ls: *FDIC chairman Seidman*

Why does the government guarantee risky ventures? Because they are risky ventures. Most of these programs were set up precisely because banks or insurance companies rejected the individuals or businesses as poor risks. The government felt it was in society's interest to give them a chance. Hurricane Hugo victims benefited from the federal flood-insurance program, which was created in 1968 to help people with houses susceptible to flooding, because private insurers didn't want to back them. Federal crop insurance is used far more frequently in North Dakota, where the climate is often harsh, than in Maryland, where it's milder. Firms aren't even eligible for Small Business Administration loan guarantees unless they've been turned down by banks. The default rate on these loans is nearly 10 times that for similar private-sector loans.

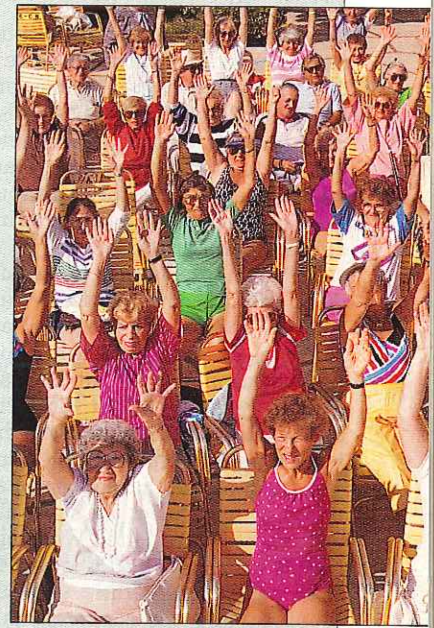
Even when loans go sour, a program may be good public policy. Despite the high de-

The Government's Golden Handshake

Generous pensions have always been drawing cards for those seeking government careers. Small wonder. Washington's retirees can look forward to golden years with a lot more gold than their private-sector counterparts. The average federal pensioner will collect $718,000 in benefits during retirement, compared with $200,000 for a private employee. But the system may soon buckle under the weight of its own largesse. Swollen by an army of young, healthy retirees—many embarked on lucrative second careers—the federal pension system faces an inevitable shortfall. Its "unfunded liability," the amount of money it doesn't have in hand but must eventually pay, now tops $1 trillion.

There is little impulse toward reform in Congress, which delivers handsome pensions to ex-members. If House Minority Leader Robert Michel retires in 1993 as expected, he will pull down $100,573 a year—even better than the $89,500 congressional salary. "Frankly, I am embarrassed by the riches," says Hastings Keith, a former Republican congressman from Massachusetts. He should know. He collects $60,000 a year in congressional and other civil-service benefits, an additional $13,000 from the Army as a reserve colonel, $12,000 in widower's benefits from the death of his wife—also a government employee—and $11,000 in social security. In January he will get a 4.7 percent cost-of-living increase on each stipend. Keith uses part of the money to fund the National Committee on Public Employee Pension Systems, a lobbying group that wants less, not more.

Washington may be on the hook for private pensions as well. Through the Pension Benefit Guaranty Corporation (PBGC), the government insures an estimated $20 billion to $40 billion in "underfunded" private pension plans that could go belly up. Created in 1974 as a safety net for workers, federal officials say PBGC has been exploited by managers of ailing industries as a dumping ground for pension obligations. After Dallas-based LTV Corp. filed for protection under federal bankruptcy laws in 1986, it ended pension plans covering approximately 100,000 workers. PBGC assumed responsibility for a portion of the benefits until the steelmaker reorganized. LTV soon reinstituted a plan promising its people essentially the same level of benefits—but with PBGC continuing its subsidy. PBGC sued; it has lost two rounds in court. Should PBGC lose an appeal to the Supreme Court next year, it will be liable for a $2.5 billion bailout of LTV. New regulations now force employers to pay more into the PBGC pot,



SUSAN GREENWOOD—GAMMA-LIAISON

Bitter pill? *Florida retirees*

but the corporation still has more obligations than cash to meet them. Without more money or reforms, workers expecting pensions may find only bitter pills.

ELEANOR CLIFT *in Washington*

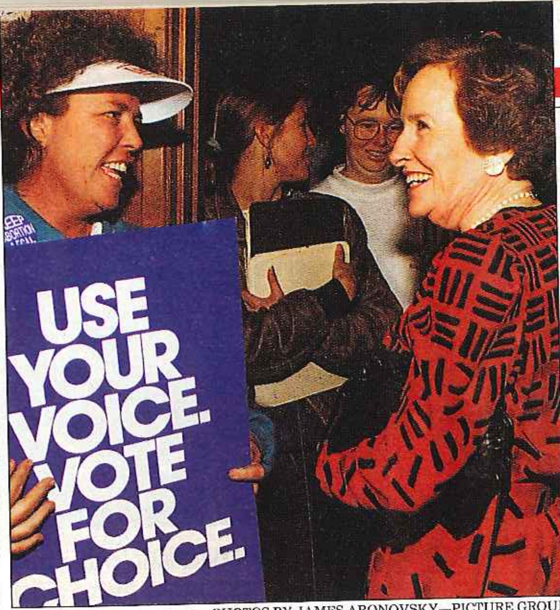
fault rate for student loans, the program is arguably far cheaper than giving students outright grants or paying the long-term social costs of not having them go to college or trade school. The Federal Housing Administration's guarantee has made ownership possible for millions who otherwise wouldn't be able to get mortgages.

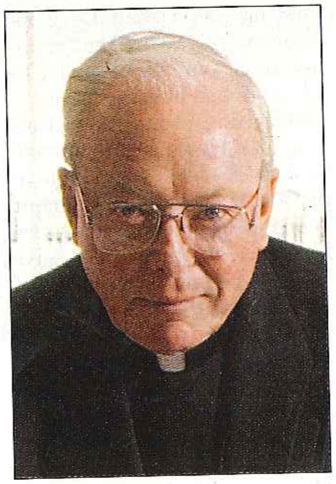
But whether it's called a loan guarantee or insurance, it is nevertheless a government subsidy. And sometimes the government's involvement can have consequences that go far beyond the scope of a particular program. Federal housing guarantees helped fuel a glut of construction that left half-finished and empty buildings from New England to the Rockies. And student-loan guarantees have financed even fly-by-night trade schools. From 1986 to 1988, 100,000 students were stuck with $30 million in debt and nothing to show for it when their schools closed at midyear. "The students owe [thousands in loans] but can't get a job because they're not trained," says Education Department Inspector General James Thomas Jr. "And they can't get [government money] for training because they defaulted on their first loan."

Sweetening benefits: The Education Department has begun cracking down on lenders that don't try hard enough to collect loans and on unscrupulous trade schools. Other agencies have pledged tougher enforcement, too. But program reforms sometimes have perverse side effects. To end the crop-insurance program's domination by a relatively small group of risky farmers, Congress has sweetened the benefits to attract more participants. As a result, after the 1988 drought some farmers were able to collect both crop insurance and disaster assistance.

Reforming the biggest programs will require taking some politically unpopular steps. Schumer plans to offer legislation requiring Congress to set aside money each time an agency gives out insurance or a loan guarantee, but that will increase the deficit. Raising the down payments for houses would help stem FHA losses but would also make it harder for some families to buy property. Yet the sheer size of the S&L collapse has jolted Washington into taking a hard look at the problem. The Bush administration is preparing reform proposals and key congressional leaders are "poised to act," says Rep. J. J. Pickle, chairman of the House Ways and Means oversight subcommittee. Not coincidentally, two advocates of reform have been Sens. John Glenn and Don Riegle, both under scrutiny in the S&L scandal. The thrift crisis may have a silver lining after all: it gives a glimpse of what the future will hold if government doesn't fix these programs.

STEVEN WALDMAN *with* RICH THOMAS *in Washington,* CLARA BINGHAM *in Lexington, N.C. and* KAREN SPRINGEN *in Chicago*





PHOTOS BY JAMES ARONOVSKY—PICTURE GROUP

From underdog to 'instant martyr': *Killea (left) after her victory, Bishop Maher*

The Church Strikes Back

The clergy pressures pro-choice Catholic pols

Lucy Killea appeared to be the underdog. In a special election for a California state Senate seat, the Democratic assemblywoman was running in a heavily Republican San Diego district where almost 40 percent of the voters are Roman Catholic. Though Catholic herself, Killea, 67, is pro-choice, and said so in her television ads. Last month San Diego Bishop Leo Maher faxed Killea a letter notifying her that she could no longer take communion. A poll showed that voters resented the widely publicized sanction, and Killea won last week by nearly 2,500 votes. "In one letter, [Maher] created an instant . . . martyr," said Carol Bentley, Killea's opponent.

With opinion polls and recent elections showing the pro-choice movement gaining momentum, the Roman Catholic hierarchy has gone on the offensive. This fall the clergy has pressured politicians as well as Catholic universities to hold the doctrinal ground against abortion. At the National Conference of Catholic Bishops last month, the prelates called for "constitutional protection [for] unborn children." Some Catholics worry that the crusade runs the risk of reviving old suspicions, put to rest by John F. Kennedy's election, that the church seeks political influence. Says Mary Jean Collins of Catholics for a Free Choice, an abortion-rights group: "The backlash could come against all Catholic politicians."

Many Catholic lawmakers say they do not personally condone abortion, but support the right to choose. Some are new to that position: Ohio Attorney General Anthony Celebrezze Jr., a Democrat expected to declare his candidacy for governor, announced recently that after years of opposing abortion he now believes "women have the right to make decisions that affect their bodies." The church says politicians can't have it both ways. "Their position sets up a false dichotomy between public and private morality," says Montana's Bishop Elden Curtiss, who asked four state officials to fill out questionnaires explaining why they support abortion rights.

Forbidden ads: Church leaders have also found the pro-choice movement making headway closer to home. At Marquette University in Milwaukee and Georgetown University in Washington, both Jesuit schools, officials took action against student newspapers for running ads for pro-choice rallies. A student group at Chicago's Jesuit Loyola University could lose the right to hold meetings if school officials determine that recently they had crossed a line from discussion of abortion rights to advocacy. "Students [contradict] the bishops' teachings on poverty and arms control," says Marquette theology professor Daniel Maguire, "but if you move into the area of 'pelvic orthodoxy,' you can get conked."

Not all clerics preach retribution: in Chicago, Cardinal Joseph Bernardin refuses to punish Illinois's pro-choice attorney general, Neil Hartigan. "My own pastoral approach will continue to be one of dialogue and persuasion," he says. The clergy is unlikely to adopt a uniform policy. But those who want to press the issue will have to consider the potential impact of penalizing such high-profile leaders—and abortion-rights supporters—as New York Gov. Mario Cuomo and Sen. Edward Kennedy.

JAMES N. BAKER *with* TODD BARRETT *in Boston,* TIM PADGETT *in Chicago and bureau reports*