IRAQ'S POWER PLAY
Special Report

Newsweek

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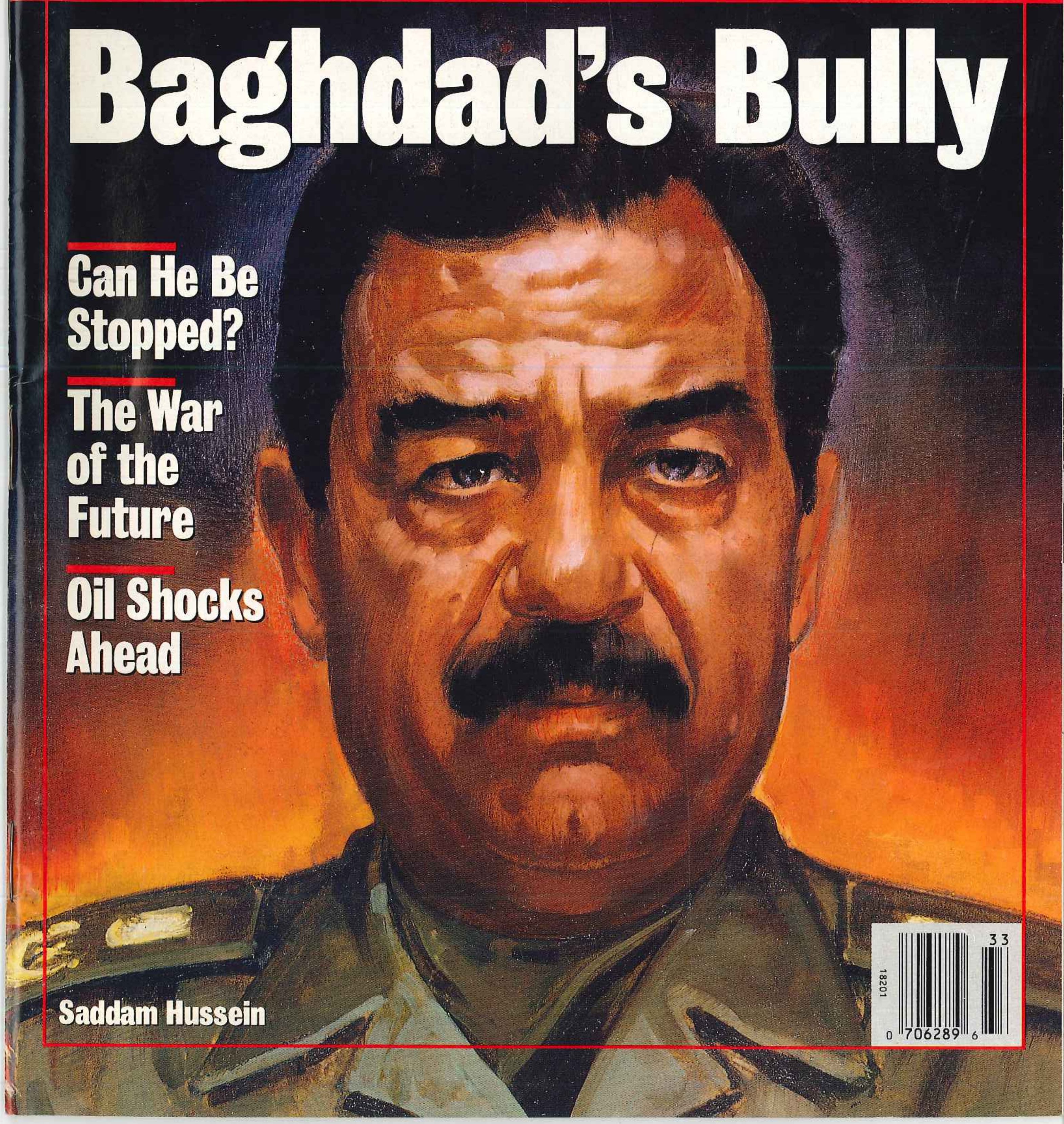
Baghdad's Bully



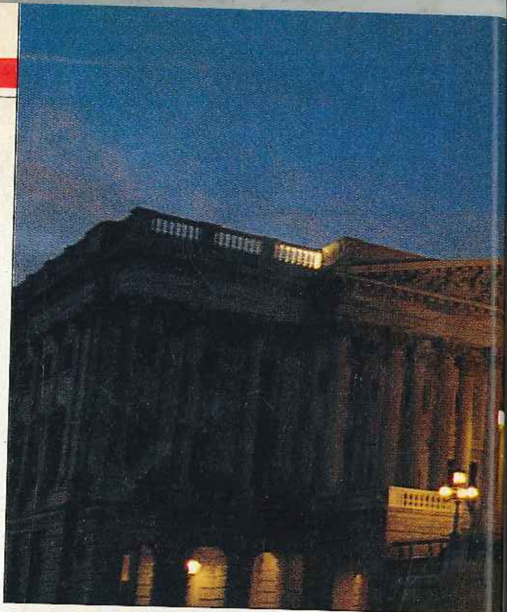
Can He Be Stopped?

The War of the Future

Oil Shocks Ahead

Saddam Hussein

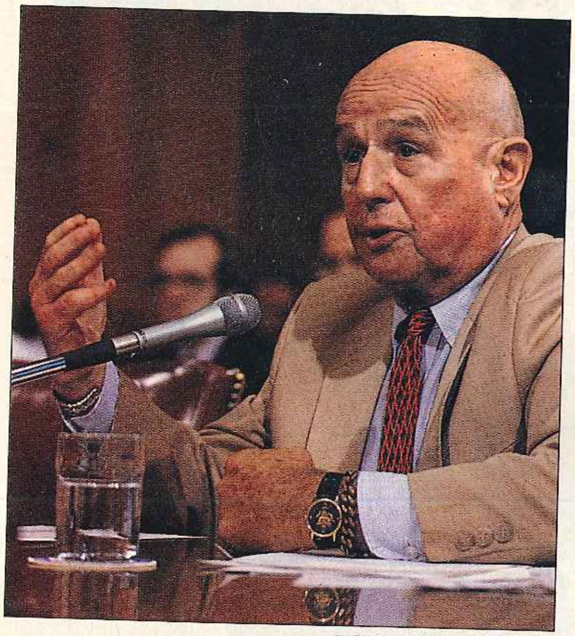
Running for Cover



As the costs of the S&L bailout rise even higher, Congress finally votes to reform itself

Voters knew the S&L crisis was bad when they started hearing it would cost $500 billion. They knew it was *really* bad when they learned it would cost each American $2,000. But a pair of votes on Capitol Hill last week showed just how shocking the crisis has become: Congress actually voted to reform itself. After years of seemingly hopeless gridlock, the Senate and House approved separate bills overhauling the campaign-finance system for the first time since Watergate. Congress must still reconcile differences between the bills and then face a possible veto by President George Bush. But the legislators saw the public mood moving so quickly toward a throw-the-rascals-out rage that they felt they had to do something. As Rep. Mike Synar of Oklahoma explained: "It's clear that Americans have a high level of disgust for us."

Unfortunately, the sudden movement of campaign-spending reform was the only hopeful development the S&L scandal produced in an otherwise doleful week. Budget negotiations broke down without the slightest progress toward shrinking the deficit by the colossal sum of $50 billion (page 34). The previous day, chief S&L regulator William Seidman brought Capitol Hill news that made the hair-pulling over $50 billion seem almost comic: the thrift bailout would need twice as much—an extra $100 billion—and right away. And if that weren't bad enough, Seidman, in his role as chairman of the Federal Deposit Insurance Corporation, was back the next day with another by-the-way: the insurance fund for the nation's banking system—three times the size of the S&L industry—is under "considerable stress." All that seemed mild by Friday when economists started musing about whether Iraq's invasion of Kuwait would inflate oil prices enough to push the already sluggish American economy into a recession.



LARRY DOWNING—NEWSWEEK

Warnings about the banks: *Seidman*

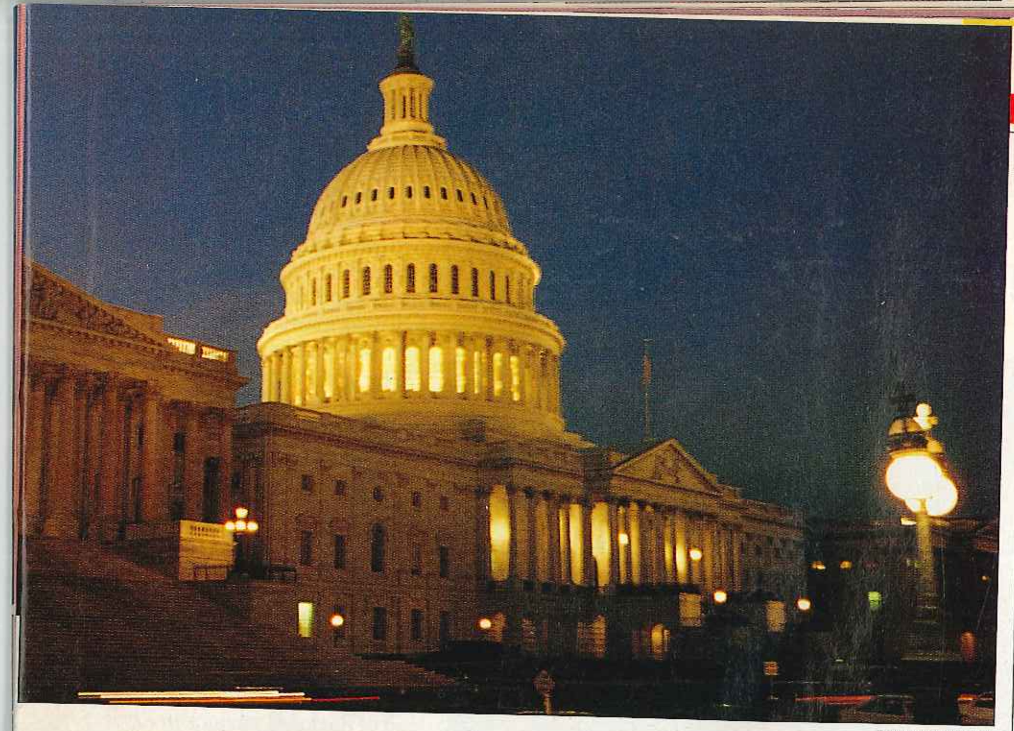
No thrills: There was still a chance to savor last week's good news. While the campaign-finance bills leave several loopholes and differ sharply in some respects, they both curb political-action committees (PACs) and move toward a system of voluntary spending limits. Candidates that limit spending could be rewarded with low-cost mail and TV, and, in the case of the Senate bill, public funds. Reform advocates like Sen. David Boren of Oklahoma have argued that only restricting the amount of spending (not just the sources) would reduce dependence on private contributions.

JOHN FICARA—NEWSWEEK

Dramatic steps or 'a parade of political posturing'? *Sen. David Boren*

But neither party was thrilled: Democrats fear curbs on PACs, which give more to them, while Republicans fear spending limits would prevent them from raising enough money to topple Democratic incumbents.

So damp was the enthusiasm for reform that some wondered whether the votes last week were, in the words of the Capitol Hill newspaper Roll Call, "a sham, a charade, a parade of political posturing." Since Bush has threatened a veto because of the spending limits, senators may have voted for a tough bill thinking it would never become law. The joke may be on them. Each side may be expecting someone else to kill the bill, yet even Bush might find it impossible to spike reform in this climate. Groups like Common Cause and Public Citizen consider the House bill, with its loose spending limits, to be much weaker than the Senate version, which more tightly controls overall



BRUCE HOERTEL

Congress Cleans Up Its Act

With the S&L scandal baring the depth of corruption in congressional campaign financing, both houses scrambled to reform the system. Highlights of the plans:

New Senate Limits

Honoraria: As in the House of Representatives, senators may no longer accept outside speaking fees.

Spending limits: Candidates can restrict themselves to $950,000 to $5 million in spending, depending on their state's size, in exchange for lower TV and postal rates.

PACs: Political-action committees cannot participate in federal elections.

Public financing: Pays broadcast subsidies to complying candidates.

The House Plan

Spending limits: Voluntary House campaign budget caps of $550,000 per election, with compliance incentives.

PACs: Contributions by PACs can account for no more than 50 percent of a candidate's war chest.

Advertising rules: Any TV ad must include a statement from the candidate taking responsibility for its content.

Tax credits: Small, in-state campaign contributors will receive tax credits on donations of $50 or less.

costs and bans PACs entirely. But reformers say the S&L scandal will enable them to come back next year and try again.

In case the legislators needed any reminding why the public is irritated, Seidman helped them with his $100 billion request. This time he wasn't just speculating about future costs: it was time to start writing the big checks. "When you are hunting and pecking for $5 million for early-childhood education in your district and they say they need [$100 billion] more for the cleanup, it's just nauseating," says Rep. Charles Schumer, a New York Democrat. Some members even suggested that Congress simply refuse the request. "I don't think the people in Congress are going to give this to you," Republican Rep. Toby Roth of Wisconsin told Seidman. But they really have no choice. The money now is going mostly to pay back depositors. "For God's sake, the money's going to their neighbors and friends, not to people in striped suits with big houses and yachts," said John Robson, Treasury deputy secretary. If Congress reneged on the promise to back up these accounts, consumers might pull their money from S&Ls and make matters much worse. Regulators seized the United Savings Bank last week in Vienna, Va., after depositors heard the thrift was in trouble and stampeded it in a 1933-style bank run.

The bad news, of course, only helped to intensify the political finger-pointing. S&Ls have now become major issues in the Kentucky, Michigan and Colorado Senate races. Even associating with a thrift is now grist for attack—as if the phrase "savings and loan" now equates roughly with "La Cosa Nostra." In the Texas governor's race, Republican Clayton Williams attacked his opponent Ann Richards merely for depositing state money into S&Ls earlier in the 1980s. Democrats last week again focused on the lucrative deals regulators gave financiers who bought insolvent S&Ls in 1988. The FBI is now reportedly investigating possible political influence on bailout decisions. A Senate panel continued to look at whether connections helped investor James Fail get a sweet deal when he took over Bluebonnet Savings Bank in Dallas. Robert Thompson, a former Bush aide who lobbied for Fail, refused to testify last week but told NEWSWEEK that his efforts were "just a matter of us doing what a lot of other lawyers and lobbyists did . . . To my best recollection, we didn't ask anyone in the executive branch to assist us."

Bank failures: Given the S&L problems, it's not hard to understand why lawmakers cringed at Seidman's testimony about bank troubles. He said the FDIC's fund that guarantees bank deposits was now at $11 billion, its lowest point ever, and could lose an additional $2 billion this year. A few major bank failures could wipe out the fund, leaving taxpayers to replenish it. Seidman noted that the slumping real-estate market helped drain the FDIC fund—a particularly troubling fact, since banks over the past four years have dramatically increased their holdings of real-estate loans. Several outside economists warned that the fund is doing even worse than Seidman claims, because regulators aren't accurately measuring the erosion of bank assets. The banks are "moving down the same road" as the S&Ls, says Edward Kane of Ohio State University, but they could avert major losses if Congress reforms the deposit insurance system soon. "We're only a little way down the road and the road isn't that steep."

This downward spiral would accelerate should the economy hit a recession—and last week the signs weren't good. At the end of July the Commerce Department had issued new data showing that in 1989 and the first quarter of 1990 economic growth had slowed to a crawl. Last Friday, the government announced that the unemployment rate rose from 5.2 percent in June to 5.5 percent in July, its highest level since August 1988. Finally, Iraq's invasion of Kuwait has already triggered gas price hikes of as much as 14 cents a gallon, and fears that the increases could push the American economy over the edge.

Even in the midst of catastrophe, there are usually some winners. By raising the price of oil, the invasion may boost the U.S. oil industry, which could help rejuvenate the economies of Texas and Arizona. So somewhere in Texas there may be an S&L that won't need a taxpayer bailout because of Saddam Hussein. Given the current state of the financial system, one has to find silver linings wherever possible.

STEVEN WALDMAN *with* CLARA BINGHAM *and* ELEANOR CLIFT *in Washington*