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THE \$150 BILLION CALAMITY

First of Seven Articles

For Texas S&Ls,**a Long, Nasty, Corrupt Descent**

By David Maraniss and Rick Atkinson

Washington Post Staff Writers

DALLAS

Ed Gray, ensconced in the back seat of a regal blue Rolls Royce, concluded that the stereotype was accurate: Texans were brash, gregarious, larger than life. A different breed, they displayed a raffish gusto for making and spending money.

Gray glanced across the seat at his host, Spencer H. Blain Jr., beau ideal of the new high-rolling Texas thrift executive, seemed a case in point, right down to his \$5,000 Rolex.

Not that 47-year-old Edwin John Gray had anything against making money. As the new chairman of the Federal Home Loan Bank Board, part of his job as chief regulator of the savings and loan industry was to give the nation's thrifts an opportunity to earn an

honest buck. In Texas, it was clear to Gray on this Tuesday evening, June 7, 1983, they were seizing that opportunity with both hands. As the car glided toward the dollar-green neon skyline of downtown Dallas, Gray couldn't resist tweaking Blain.

"You know," Gray said dryly, "I don't know any S&L operators who drive Rolls Royces."

"Oh, well," Blain replied. "We're just very profitable down here in Texas."

Years later, when Texas was no longer bold and unbowed, when the nation faced its worst financial catastrophe since the Great Depression and the Texas thrift industry had become a virtual ward of the federal government, Gray recalled one other peculiar scene from that night.

A band of Lone Star thrift executives, who like Gray had come to Dallas for the Texas S&L industry's annual convention, met for a party in Blain's penthouse atop the Registry Hotel. They hooted and hollered and danced around the ornate fireplace and the mock 18th century French furniture. An odd, guitar-picking duo provided the music: L. Linwood Bowman III, the lanky, sedate Texas savings and loan commissioner, and chubby, ribald Durward Curlee, lobbyist for the industry that Bowman was responsible for regulating. The two crooned for more than an hour, serenading Gray with "I'm Walking the Floor Over You" and "Lovesick Blues."

Sometimes people look but do not see, hear but do not listen. So it was for Gray during that first visit to Texas. Perhaps the setting was wrong, or the timing, or his frame of mind. Context is the filter for everything. Whatever the reason, the Rolex and the Rolls became fixed in Gray's mind, but he brushed

aside a disturbing message, delivered during the same trip, about Spencer Blain and his operation at Empire Savings & Loan in nearby Mesquite.

Commissioner Bowman privately described for Gray how Empire, once a conservative thrift in suburban Dallas, was growing at an astonishing rate, doubling and redoubling in just a few months. Then he outlined a quick-cash scheme known as a "land flip" in which Empire and several other thrifts repeatedly sold a piece of property back and forth, pocketing big fees for each transaction. Finally, Bowman told Gray of Empire's mind-boggling condominium projects east of town, thousands of units.

Strange things are going on out there, Bowman warned; someone has been dragging cars out from a junkyard to make the projects look occupied.

This warranted closer inspection by federal regulators, but Gray did not pursue the matter. When his focus was elsewhere, an aide once remarked, Gray had the attention span of a doorknob. After all, Gray reflected later, he had not gone to Dallas to sniff out misdeeds. He had been on a different mission: To urge the Texas S&L operators to take advantage of new federal legislation that unshackled the industry, removing the traditional constraints on how thrifts could attract deposits and lend money.

As a former publicist for a California thrift and a long-time press aide to Ronald Reagan, Gray accepted the prevailing ideology of the time—that free markets and deregulation were salves for economic hard times. This applied especially to the savings and loan industry, which had been mired in a three-year slump triggered by increased competition from newfangled financial enterprises that paid higher interest rates than a Plain-Jane S&L account. What the industry needed was less regulation from Washington, Gray believed, and more opportunity to grow out of its problems. "A Sure Cure for What Ails You" as he had called his speech to the Texas conventioners.

But at the very moment that Chairman Gray and the band of Texans met in Dallas, they unwittingly stood on the brink of a disaster, one in which both the Texas economy and the deregulated S&L industry went down the tubes together, tugging and clawing at each other during a long, nasty and corrupt descent. Now, as the decade nears its end, here is the result:

The Texas savings and loan industry lies in ruins. Six years ago the state boasted 287 thrifts; today, there are 140 and the number is expected to dwindle to as few as 70. Federal investigators, meanwhile, are pursuing 7,000 criminal referrals across the country in what the Justice Department's fraud section chief, William C. Hendricks III, calls "as big a systematic criminal problem as I have ever seen." Even the hundreds of thrifts innocent of wrongdoing have suffered, as an anxious and suspicious public withdraws \$1.5 billion in deposits every month. Finally, the nationwide bailout plan before Congress is expected to cost more than \$150 billion.

Like light years and nanoseconds, \$150 billion suggests a unit of measure not easily comprehended. Perhaps the best way to think about the sum—to pare it to human scale—is to consider what else the money might have bought. It could have financed the U.S. Food for Peace program at its current level for 136 years or the Drug Enforcement Administration for 262 years or federal prenatal care programs for 717 years. It could have purchased, at current prices, 47 nuclear-powered aircraft carriers or 4,717 F-15 jet fighters. It could have built 53,571 miles of Interstate highway.

Four of the men who gathered in Spencer Blain's penthouse suite that night six years ago each contributed to the calamity in a different way. Each was forever changed by it. Bowman, forced out as commissioner of the Texas Savings and Loan Department, ended his career with remorse and self-recrimination. Curlee, his lobbying days over, saw his fortune disintegrate in a bankruptcy sale on the courthouse steps. The flamboyant Blain, stripped of his S&L and permanently barred from the thrift business, is on trial on fraud and racketeering charges, which he has denied.

But no one changed more than Ed Gray, and it was his transformation that told a larger tale of human frailty and the search for moral courage.

A Fatal Flaw

Ed Gray was neither an economist nor a businessman by profession, but rather a born pitchman and cheerleader. After a brief episode as a reporter, working in the Madrid bureau of United Press International during the early 1960s, he went into public relations and made a career of saying positive things about his employers.

This decidedly average man—brown hair, square face, medium height and build—instinctively shunned controversy and conflict. He saw himself as the quintessential nice guy. His favorite sport was not tennis, but fly-fishing, alone, in the high country of his native California. He liked reading history, particularly accounts of the Dark Ages in Europe. He was seen as a close friend of the S&L industry, and when the Federal Home Loan Bank Board chairmanship opened in 1983, the industry pushed his candidacy.

Gray's attachment to Reagan began in 1966, when he helped run the press operation for Reagan's first inauguration as governor of California. When Reagan needed a Bible for the swearing-in, Gray was dispatched to Carmel to fetch the 200-year-old holy book used by missionary Junipero Serra. Gray served Gov. Reagan in Sacramento, then took his skills into private enterprise as an S&L executive.

At first glance these causes—Reagan and savings and loans—might not seem easily linked, but they fit together neatly in Gray's romanticized world view. He shared the thrift industry's self-image as the enabler of the American dream. From its inception in suburban Philadelphia in 1831, the business had portrayed itself as the benefactor of American home ownership. Nearly a century ago the thrift industry's principal trade association coined the slogan: "The American Home, the Safeguard of American Liberties."

To Gray, Reagan embodied wholesome American virtues, and that value system held the dream of home ownership. Gray thought of Reagan not so much as spokesman for corporate America but more as an average fellow, similar to the character Jimmy Stewart played in the 1946 Hollywood classic, "It's a Wonderful Life"—a small-town thrift executive who was patient and forgiving of his mortgage customers during hard times.

The industry that Gray joined in the mid-1970s had not changed much since the era portrayed in the movie. It remained a relatively simple business dedicated to making mortgage loans on single-family residences. Federal law capped the interest rates an S&L could pay its depositors, but thrifts lived comfortably on the consistent, seemingly immutable, profit spread of 2 or 3 percentage points between deposit and loan rates. Furthermore, since 1934, the system had been virtually risk free, with deposits guaranteed by the Federal Savings and Loan Insurance Corp. (FSLIC). Hence the industry's lighthearted motto: "Three Six Three"—pay depositors 3 percent interest, lend at 6 percent, and hit the first tee at the country club by 3 in the afternoon.

As the 1980s began, thrift executives were still playing golf—they would never relinquish the game, nor their framed pictures of Billy Casper and Arnold Palmer, nor their fairway lingo (Newark, one executive quipped, is "two woods and a nine iron from New York")—but their world had become more complicated and uncertain. The creation of money market accounts and other investment opportunities, offering higher interest rates and easily available to consumers, eliminated the advantage that thrifts had enjoyed for many decades. From a zenith in 1978, when S&Ls reported record profits, the industry went into a stunning tailspin: 18 straight months in which Americans withdrew more money than they deposited.

The first federal response, near the end of Jimmy Carter's presidency, was to remove restrictions on banks and savings and loans, eventually allowing them to offer any interest rate they desired. At the same time, Congress more than doubled the amount the FSLIC would insure in deposits, from \$40,000 to \$100,000.

This change was of more than passing interest to Gray. After working in Reagan's 1980 presidential campaign, he had moved to the White House domestic policy staff, where his territory included the savings and loan industry. Gray and others soon realized that deregulating the interest ceiling on deposits had a fatal

flaw. Thrifts now had no trouble attracting new deposits, but they were still losing money faster than ever. The thrifts were caught in a "negative spread," paying high interest on their deposits while collecting relatively low interest on the long-term mortgage loans that provided most of their income.

In Texas, inevitably, this condition was converted into an Aggie joke. Negative spread, one Austin economist said, was "like the Aggie service station owner who bought fuel at 50 cents a gallon, sold it at 45 cents, and hoped to make up the difference on volume."

A Profound Revolution

But how to respond? That is where the first fissure appeared in the Reagan team. While the administration agreed that the financial world should be deregulated, there was no consensus on what to do specifically about the savings and loan industry.

Survival was as much an issue for the industry at the dawn of the '80s as it is now, at the end. A remarkable aspect of the calamity is that after so much activity—so many proposed solutions, so many transmutations, so much mismanagement, so much venality, so many delusions, so many failures of the regulatory system—there was a problem then and there remains a problem now.

Donald T. Regan, Reagan's first Treasury secretary, who had a large voice in the administration's economic policy, held less sway when it came to the S&L issue. Despite Regan's misgivings, Gray and the U.S. League of Savings Institutions succeeded in getting their candidate appointed chairman of the Federal Home Loan Bank Board in 1981. He was Richard Pratt, finance professor at the University of Utah, a fullback of a man with a thick neck, a deep rolling voice and a commanding presence; while he did not share Gray's romantic notions of the goodness of thrifts, Pratt did believe in their utility. Above all, he believed in the value of a free market.

In Pratt's perfect world, the savings and loan industry would be neither regulated nor protected with federal insurance. He sermonized on how deposit insurance, while reassuring to customers, provided S&L operators with a perverse incentive to take risks. But eliminating the insurance was too radical even in the free market fervor of the time, so Pratt went for what he could get: legislation and rules that had the eventual effect of provoking even more risk-taking. Deregulation was his shibboleth. When recruiting Robert Mettlen of the University of Texas for chairman of the regional Federal Home Loan Bank responsible for Texas, Pratt began: "Let me ask you one question. Do you fundamentally believe in deregulation?"

Working with a troop of assistants known as the "Mormon Mafia," Pratt sought to resolve the negative spread dilemma by easing restrictions on how thrifts could be run, who could run them, and how money could be invested. Central to this effort was the Garn-St Germain Depository Institutions Act of 1982, which encouraged thrifts to move away from the home mortgage business and toward riskier—but potentially more profitable—commercial and real estate loans, development loans, and subsidiary enterprises.

At the same time, Pratt's bank board issued an equally important set of rule changes. Accounting procedures for S&L examinations were eased. Thrift owners were required to put less of their own cash in a reserve fund intended to hedge against losses. The definition of cash, or capital, for that reserve fund was liberalized to include such assets as raw land. And the requirement that thrifts have at least 400 stockholders was eliminated, wiping out the concept of community involvement.

Yet, Pratt later recalled, there were "no substantive conversations" in the early '80s about beefing up the regulatory side of the operation. Ed Gray, from his vantage point at the White House, summed up the philosophy: "The general mentality was that the regulator was to be deregulated into oblivion."

The industry underwent a swift and profound revolution. From coast to coast, consultants held seminars on how to take advantage of the new commercial opportunities in the thrift business. In Los Angeles, a law firm put out a brochure raising the question, "Why Does

It Seem Everyone Is Buying or Starting a California S&L? Among the answers: Developers operating under the thrift umbrella could tap cash resources and seize favorable deals while competitors were looking for financing.

When Pratt left office, replaced on March 24, 1983, by industry cheerleader Gray, the feeling in Washington and around the country was that Pratt had worked wonders. Nearly 750 thrifts had closed shop during his

tenure, victims, mostly, of negative spread. But those that survived reported good profits, even astounding profits. Pratt was credited with leading the industry out of the 19th century and preparing it for the 21st.

And no place in the world was more eager for the 21st century than Dallas. Oil prices had stabilized after a dizzying rush two years earlier and the energy centers of the Sun Belt—Houston and Midland—had flattened out a bit. But the whole world still seemed eager for a piece of Texas, and Dallas, real estate capital of the Southwest, was in a veritable land frenzy. Before 1983 was over, nearly 20,000 residences would be built there, the most of any metropolis in the nation. Building permits in Texas quadrupled over the number issued in the late 1970s. Much of that enterprise was financed with cash borrowed from Texas thrifts.

The Washington of Ronald Reagan was ascendant as well. Interest rates had eased and inflation dropped to the lowest level in 15 years. Much of the country was emerging from a recession and the White House was willing to take credit for it. Reaganomics had been transformed in many minds from a dirty word to a magic one.

There was, then, in the spring of 1983, an unusual convergence of two worlds—freewheeling Texas and free-market Washington—at a time when each was thought to have reached a pinnacle of economic success. In Texas, boom times were taken as something more than mere luck or geographic circumstance. They were seen as a confirmation of Lone Star values: pioneer spirit, frontier ethic, anti-government bias and entrepreneurial style.

But in hubris there is self-deception. In this case it was monumental.

A Cautionary Step

Back in Washington in the fall of 1983, Chairman Gray began to receive troubling reports from his staff at the Home Loan Bank Board. At the October meeting of the enforcement staff, he learned that thrifts around the country—especially those in Texas—had shown explosive growth in the previous four months. The suddenly resurgent S&Ls were using their newfound cash to make risky development loans, Gray was told.

By the end of the year, Gray had heard enough to take a mild, cautionary first step: requiring new thrifts to increase their cash reserves as a protection against loan losses. This provoked a harsh reaction from his friends at the U.S. League, as Gray later recounted the episode. Several league officials suggested that imposing restrictions on new thrifts would hurt the organization, which needed all the new members it could get.

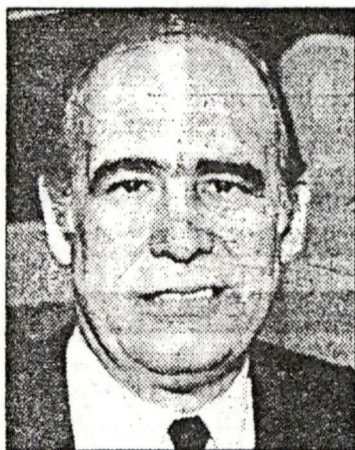
The last thing Gray wanted was to displease the industry. League president William B. O'Connell, an occasional lunch partner and Gray enthusiast, had mentioned that the chairman might be a leading candidate to succeed him someday. The salary of \$275,000 a year rang loud in Gray's mind. He had spent his career being a nice guy. He wasn't used to being jostled, knocked around, criticized, especially by his friends. These guys have never seen the other side of me, he thought to himself, but then neither have I.

This insight troubled him, in no small measure because he realized that he wasn't going to be able to make everybody happy.

NEXT: Diving off the deep end

Staff writers Kathleen Day and Charles R. Babcock and staff researchers Elizabeth Hudson and Melissa Mathis contributed to this article.

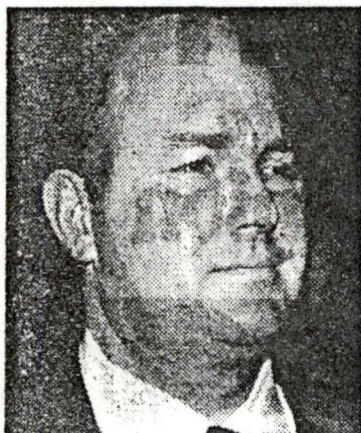
THE REGULATORS AND THE REGULATED



EDWIN J. GRAY, chairman of the Federal Home Loan Bank Board for four years, became the nation's top S&L regulator after stints as a Reagan aide and as an S&L public relations executive.



L. LINWOOD BOWMAN III, a former thrift executive who served as Texas S&L commissioner from 1982 until 1987, was the state's chief regulator during the rise and fall of the Texas thrift industry.



SPENCER H. BLAIN JR., majority stockholder of Empire Savings and Loan until it was taken away from him, also served as vice-chairman of the Federal Home Loan Bank of Little Rock.



DURWARD CURLEE became the lobbyist for the Texas Savings and Loan League in 1973 and then went to Washington in 1984 on behalf of 20 Texas thrifts, most of which eventually failed.

THE \$150 BILLION CALAMITY

Second of Seven Articles

Only Ambition Limited S&L Growth**Office's Move to Dallas Hampered Regulators as Key Staff Departed**By Rick Atkinson and David Maraniss
Washington Post Staff Writers

DALLAS

In September 1983, after 50 predictable years in Little Rock, the Federal Home Loan Bank regulating the savings and loan industry in the Southwest succumbed to the inevitable by migrating to Dallas, money magnet of the American Sun Belt.

The move went badly.

Thirty-seven of 48 employees in the bank's division of supervision, including the chief, quit rather than relocate. For months before the move, the booming thrift industry in the bank's five-state region received virtually no attention from federal watchdogs. Those supervisors who intended to resign began looking for new jobs in Arkansas; those remaining began looking for new homes in Dallas.

Most of the 11 employees making the move were secretaries or low-level assistants. Only two worked in the field as supervisory agents, and they faced a daunting task upon their arrival in Dallas. The district bank's 500,000-square-mile region contained 480 S&Ls; some were doubling or tripling in size every few months. Despite rules calling for annual examinations, many had not been scrutinized in years by federal examiners, who served as the supervisors' early warning system in detecting problems.

Forced to improvise, those two surviving field agents, Charles Brooks and William Churchill, split District 9 in two. They chose the Red River as their line of demarcation: Brooks would supervise all thrifts north and east of the Red—those in Arkansas, Louisiana and Mississippi—while Churchill supervised everything south and west of the Red, mostly in Texas and New Mexico. Each agent shouldered a caseload of roughly 240 institutions. (In later years, a supervisory load of two or three thrifts per agent was considered more than enough work.)

Some regulators would have been intimidated. But Brooks, Churchill and their colleagues felt little anxiety. For 50 years, the regulator and the regulated had lived harmoniously under a system built on trust, tradition and mutually accepted rules of the game. "We were naive," one supervisor lamented recently. "It was inconceivable to us that people could be doing [anything] to harm their own institutions."

Even before reaching Dallas, the little band of regulators could see that life in Texas was going to be different. Leaving Little Rock for the last time,

they drove southwest on Interstate 30, through Texarkana, and across the long, low bridge spanning Lake Ray Hubbard, where new housing tracts pushed to the water's edge. Beyond the west shore of the lake, as the Dallas skyline popped into view, the development grew ever denser, with thousands of new apartment buildings and condominiums crammed into a 10-square-mile corridor bracketing the interstate. An instant city had blossomed on the prairie, much of it financed by Empire Savings and Loan of Mesquite, which had sunk hundreds of millions of dollars into the enterprise.

"This," district bank official George Barclay told his wife as they whizzed past, "is like Brooklyn without the laundry lines."

But there was another difference, too. Brooklyn was solvent.

A 'Dead Gut Cinch'

Like its 11 sister institutions under the Federal Home Loan Bank (FHLB) system, the District 9 bank had two functions. The first was to lend money to thrifts in the region and provide other banking services. The second was to scrutinize those thrifts to be certain they were financially healthy and did not jeopardize the Federal Savings and Loan Insurance Corp. (FSLIC), which guaranteed S&L deposits. Member thrifts owned the district bank and elected the directors who ran it. This was a system constructed on conflict, since the thrifts were regulating themselves. To preserve some independence, the regulatory side of the Home Loan Bank was segregated from the banking side.

The district banks provided jobs and prestige. For 30 years Texas had resolutely tried to lure the District 9 bank to Dallas, arguing that the city had no peer in the Southwest as a financial capital; for 30 years, Arkansas just as resolutely resisted. In 1958, when the Texas Savings and Loan League voted—as it did perennially—to lobby for the move, the league president found a one-line telegram under his hotel door in Galveston that night. Signed by Sen. John L. McClellan, the powerful Arkansas Democrat who chaired the Senate Appropriations Committee, the message read simply: "You're whistling Dixie."

Eventually the influence of the Arkansas congressional delegation waned. In early 1983, when the issue arose again, Arkansas' two senators held up the nomination of Edwin J. Gray to become chairman of the Federal Home Loan Bank Board in an effort to obtain his support. But the directors of District 9 voted 11 to 2 to move, with the Bank Board's consent. Gray, three weeks after taking office, proudly cast his vote in favor.

To Gray, the move made great sense. A Home Loan Bank's business, he believed, was to know what was going on in the district, and perhaps nowhere in the country was more going on than in Texas. Fueled by a near quadrupling of oil prices to a peak of \$35 a barrel in 1981, the boom had provoked more than a little Lone Star arrogance. "Drive 70 and Freeze a Yankee," bumper stickers proclaimed. "90 in '90," the oilmen assured each other, meaning \$90 a barrel in 1990.

Behind the oil boom came the real estate boom. Developers rushed to build houses and condominiums for the masses who would surely emigrate to Houston, to Austin, to Big D. Texas real estate, in the local idiom, was a "dead gut cinch." Only the most incompetent fool could lose money. Texas was fated to become the new California, a Sun Belt Manhattan, where land prices climbed and climbed and kept on climbing.

Hundreds of savings and loan associations from around the country jockeyed to finance the developers, funneling billions of dollars into construction virtually overnight. "If you could walk, talk and say, 'I am a developer,'" one thrift expert said later, "you could borrow \$10 million." Often it was easier, much easier, for an ambitious builder to borrow that \$10 million—with less paperwork, little or no down payment, and no credit check—than for an ordinary working stiff to borrow \$100,000 for a traditional home mortgage loan.

A cozy symbiosis evolved between lenders and borrowers, as federal regulators later discovered. Frequently, a developer needing \$10 million instead received \$12 million from a friendly savings and loan. Ten million dollars went directly to the borrower, minus several hundred thousand in fees to the thrift; \$2 million went into an "interest reserve" account to cover interest payments for two years.

Each month, the S&L drew money from the reserve account as a "payment" on the loan; these payments showed up on the thrift's books as profits, nimbly misleading any nosy examiner and justifying large dividends and bonuses to the S&L executives. If the interest reserve dwindled, another sympathetic thrift refinanced the deal and began the cycle again.

The only business in Texas that was more of a dead gut cinch than real estate was owning your own savings and loan. After the grim period of the late 1970s and early 1980s, when the lethal surge in interest rates had felled more than 100 Texas thrifts, the industry bounced back smartly. Developers recognized that new laws and rules adopted in Washington meant that, with a relatively modest investment, a real estate man could own his own thrift and, by luring deposits with high interest rates, have millions of dollars at his disposal. The new rules permitted any S&L, whether owned by saint or sinner, to grow at a rate constrained only by ambition.

In 1982, for example, the Bank Board in Washington removed restrictions on an S&L's ability to attract "brokered" funds. A broker in New York or San Francisco could sit at a computer, go *click-click-click* on the keyboard, and the screen would flash a list of the 50 institutions paying the highest interest rates. With another *click-click-click*, the broker shoveled his customers' cash electronically into the most attractive thrifts. Usually, the broker packaged the money in deposits of less than \$100,000 to keep each account within the limits of federal insurance coverage. As often as not, the best interest rates could be found in Texas. Billions of dollars poured into the state's thrifts.

Bank Board Chairman Gray did not like brokered deposits. The phrase "gasoline on a bonfire" kept recurring in his mind. A thrift regulator was supposed to know what was happening to the money moving through the industry, and Gray had to admit that he possessed only the sketchiest notion. The best way to bring this blaze under control, he concluded, was to stop the flow of gasoline. Some skeptics believed Gray had taken this position only after sensing that he wouldn't offend the leadership of the U.S. League of Savings Institutions. Regardless, Gray proselytized against brokered funds with pulpit-pounding fervor; wheedling, exhorting, pleading, he convinced the Bank Board staff, as well as the two other Bank Board members, of the righteousness of his cause.

Yet he failed to convince the big Wall Street brokerage houses, and he certainly failed to convince the Texas thrifts, which faced the loss of a major revenue source. In the late fall of 1983, Gray made his second trip to Texas to drum up support. He was irritated to find that his opponents also included the Texas state commissioner, L. Linwood Bowman III, who thought Gray was misguided in focusing on the source rather than the misuse of the money. "You give a chain saw to an untutored man and he'll cut off his legs," Bowman explained in his folksy drawl. "But give it to a tutored man and he'll build houses with it." And anyone could see that Texas was building a lot of houses.

Ed Gray lost the brokered funds battle. A federal judge ruled that his attempts to curb the practice exceeded his authority as Bank Board chairman. For the first time, Gray had locked horns with the Texas thrift industry. It would not be the last.

Money continued to gush into Texas. Small thrifts became large, large thrifts became huge. As Dallas district bank Chairman Robert D. Mettlen later observed, "The temptation for a few folks to dive off the deep end was irresistible."

Dangerous Growth

No institution dove deeper than Empire Savings and Loan, the thrift that had invested so heavily in the I-30 corridor east of Dallas. Once a small S&L headquartered in a suburban shopping strip, Empire had been purchased in the late 1970s by the son of a Mississippi sharecropper, D.L. (Danny) Faulkner, who first made his fortune by winning the contract to paint Texas Stadium, home of the Dallas Cowboys.

Faulkner evinced a magnetic charm that drew dozens of admirers to his Saturday morning breakfasts at the Wise Circle Grill on Bobtown Road east of Dallas. As the parking lot filled up with Rolls Royces and Mercedes Benzes, Faulkner—the very picture of ruddy bonhomie—held court inside over steak and scrambled eggs, giving speeches, cutting land deals, and handing out Rolex watches and diamond stickpins with a little "F" between two mountain peaks.

In the summer of 1982, Faulkner turned Empire over to his protegee, Spencer H. Blain Jr., who became majority stockholder and soon showed his taste for Rolexes and Rolls Royces. Blain was one of the brightest stars in the Texas thrift firmament: president of an Austin S&L, vice chairman of the Home Loan Bank before the move from Little Rock, president of the Texas Savings and Loan League. Brusque, flashy and often cheeky, Blain on two occasions—including an ugly shouting match in a hotel lobby—had publicly rebuked the district bank's chief supervisor for suggesting that Blain's Austin thrift was growing at a dangerous rate.

Within months, Empire claimed to be the fastest growing, most profitable thrift in America. Deposits soared from \$17 million in mid-1982 to \$309 million in early 1984, largely on the strength of brokered deposits. But to afford the interest Empire paid to attract those deposits, Blain needed to invest the new wealth. Empire Savings and Loan became, in effect, a development company that could lend itself as much money as necessary.

Federal investigators later alleged that Empire also worked with other thrifts to artificially inflate real estate prices through "land flips." During one two-week

period in November 1982, for example, Empire and its partners sold one tract back and forth repeatedly, ballooning the price from \$3.2 million to \$96 million. Along the I-30 corridor, land allegedly was flipped so quickly that prices rose from \$1 per square foot to \$10 in a week. Such sales, sometimes expedited by compliant appraisers, permitted the S&L to make ever larger loans on each transaction, which in turn formed the basis for collecting ever larger fees and closing costs, according to federal investigators.

Several participants in the land flips were later convicted, some for filing false income statements to qualify for the loans. Blain said he had done nothing wrong and has pleaded not guilty to criminal fraud charges. "I'm not ashamed of anything I've done, don't believe I've broken any laws, believe that the theory [with which] I operated Empire was sound," Blain said during a deposition in a related civil suit.

If Empire was no longer somnolent, the regulators remained sound asleep. Empire had failed to notify the Bank Board, as required, when Blain took over. No action was taken. Empire's internal auditors, Coopers & Lybrand—which served as another early warning system against imprudence—struggled to complete an audit of the thrift's chaotic books in September 1982. Unable to meet the deadline, the auditors asked the Home Loan Bank for an extension, then another and another, until nine such requests had been made over the course of a year. The Home Loan Bank granted each.

In a pattern that surfaced repeatedly in subsequent years, federal examiners sensed that something was badly amiss at Empire, only to have their superiors not act upon the warnings. An October 1982 examination report, using such terms as "imprudent" and "risk" and "speculative," noted that in more than a dozen huge projects "borrowers had little or no funds invested." In reviewing 68 real estate loans, the examiners found that Empire had not obtained appraisals on more than half the projects to determine whether they were financially sound. Empire, the examination noted, had set up a subsidiary to help "service" its real estate deals, appointing none other than Spencer H. Blain Jr. as a consultant entitled to 25 percent of the company's net profits.

On a best-to-worst scale of 1 to 5, the examiners gave Empire a rating of 3, which was supposed to trigger a meeting between Home Loan Bank officials and Empire's directors. No meeting took place. "It is felt," the bank's supervisory agent wrote to Washington on Jan. 15, 1983, "that our . . . concerns can be handled through correspondence." On paper at least, the supervisor added, Empire looked immensely profitable.

But when federal agents wrote to Empire that month, asking the thrift to follow prudent practices—such as requiring borrowers to risk at least some of their own money—the thrift's executives did not answer for months. Finally, on April 6, Blain replied with "a bland and nonresponsive 'kiss off,'" as congressional investigators later characterized it.

Again, no action was taken.

Forced to Act

Beyond institutional timidity and the confusion caused at the district bank by the move to Dallas, much of the blame for the dilatory federal response reflected

the inefficient structure of the regulatory system. Examiners, the green-eyeshade accountants who scrutinized a thrift's books, were segregated from supervisors, the field agents responsible for taking action on the basis of the facts unearthed by the examiners. They had been split since the late 1930s, when the S&L industry bitterly complained that the examiners were too tough in their critiques.

Consequently, examiners reported to the Bank Board as civil servants earning a starting salary as low as \$13,000, ripe for "cherry picking" by S&Ls offering \$40,000 salaries and a company car. (Approximately one-third of the 120 examiners working in the Southwest resigned each year.) Supervisors worked for the district banks as somewhat better-paid quasi-governmental agents. Communication between the two groups was poor and occasionally hostile. "You had an insane system," one Bank Board senior executive later noted, "that guaranteed rivalries and things falling between the cracks."

So it was with Empire. The examiners' reports arrived on the supervisors' desks, first in Little Rock, then in Dallas, and went into a deep stack of reports on dozens of other "troubled" institutions. A June 23, 1983, regulatory memo noted that Spencer Blain had purchased a 65-acre tract for less than \$1 million and sold it six months later—to a major Empire customer—at a \$15 million profit. Yet, congressional investigators subsequently wrote, "Nothing was done."

An examination conducted two months later, on Aug. 19, 1983, downgraded Empire's rating to a 4, noting land flips and other "unsafe and unsound" practices. Even then, state and federal regulators moved glacially, fearful of shutting down an institution that—on paper, at least—appeared to be the most profitable thrift in America.

At Bank Board headquarters in Washington, the "Empire problem" seemed eminently postponable. Chairman Gray had received three warnings about Empire—one from Texas S&L Commissioner Bowman in June 1983, and two from Dallas bank president Joe Settle—but none compelled his attention. Empire seemed to be just one of many thrifts trying to adjust to a deregulated industry.

Finally, the sheer weight of information suggesting fraud, imprudence and insolvency was too much to ignore. The state regulators moved first. Bowman recognized that Empire was in too much trouble to save itself, and on Jan. 12, 1984, the state seized control of the thrift.

Bowman's federal counterparts now were forced to act, 17 months after first detecting problems that, the examiners had warned, required "immediate, forceful supervisory action." The FSLIC dispatched a consultant, Frank Augustine, to Dallas to evaluate Empire's holdings. Within two weeks, he made detailed oral and written reports to Washington; yet verbal descriptions were not enough, Augustine decided. The Bank Board needed a graphic understanding of what was happening.

Hiring a former World War II bomber pilot, Augustine climbed into a small plane one day in late February, checked to be sure he had plenty of tape for his video camera, and headed toward the I-30 corridor.

NEXT: The making of a zealot

Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.

Turning Anger Into Action on Thrifts

By Rick Atkinson and David Maraniss

Washington Post Staff Writers

An unusual solemnity hung over the senior staff of the Federal Home Loan Bank Board as they filed into the sixth-floor conference room at 9:30 a.m. on March 14, 1984. The freezing drizzle of the previous day had stopped, but a wintry chill and pewter sky lingered above Washington, muting the morning light that ordinarily flooded through the wraparound windows overlooking Pennsylvania Avenue.

The agenda for this Wednesday meeting included a weighty decision: whether to shut down Empire Savings and Loan of Mesquite, Tex., by declaring it hopelessly insolvent. Such a radical action—the first ever taken against a Texas thrift—would mean the largest insolvency in the 50-year history of the Federal Savings and Loan Insurance Corp. (FSLIC), which stood to lose \$165 million. To help illustrate Empire's financial plight, an FSLIC consultant had prepared a videotape.

As the three Bank Board members settled into their chairs, a staff assistant wheeled in a large cart holding a television set and videocassette recorder. Positioning the cart a few feet from the chairman's seat, the assistant slid a black cartridge into the VCR.

For 20 minutes and 41 seconds, the small group in the conference room watched in stunned silence as the consultant took them on a tour, first by air, then on the ground. Thousands of apartments and condominiums—most of them vacant and many badly built—swept past the camera lens as the unseen narrator described the catastrophe in a leaden monotone:

"Looking west toward downtown Dallas, we can begin to see the hundreds and hundreds of units that are under construction, none occupied . . . Building after building, probably 24- to 30-plexes, all unoccupied . . . Other mature projects, probably complete for a year, and no occupancy . . . The problems of security, vandalism, fire, control,

completion—all are readily apparent from pictures like these.

"A project called Snug Harbor—vacant. On Faulkner Point North, numerous projects, numerous buildings, virtually totally vacant. No sales effort, no leasing effort, and across the street, more slabs and active construction.

"Notice the incredible waste, the total lack of contractor control . . . Evidence of arson is already available . . . In the distance, numerous projects, virtually 100 percent complete, no occupancy, and the land between the camera and the buildings is being prepared for more development . . . This particular series of buildings made up one project, apparently totally vacant, with severe freeze damage inside of each unit."

The tape ended and the screen went blank. Edwin J. Gray swiveled his chair back to the oblong conference table. For once, the usually loquacious Bank Board chairman had nothing to say; he had been up since 5 a.m. preparing to testify before a House subcommittee later in the day and had given little thought to the Empire matter.

But halfway through the video, he had shut his eyes, appalled, sickened by the vulgarity of this excess. Gray had been cautioned that Empire Savings was in trouble. But the warning had seemed distant, casual, easy to ignore. This 20-minute documentary was his first visceral comprehension that something dreadful was happening within the industry he was supposed to be regulating. He could not imagine a more graphic illustration of how hundreds of millions of dollars were simply evaporating. The video, he thought, was fiduciary pornography.

After the shock, Gray got angry. In a quick vote, the Bank Board voted to place Empire in receivership and forever ban majority stockholder Spencer H. Blain Jr. from the savings and loan industry. The Bank Board staff began legal proceedings, which led to fraud and racketeering charges against more than 100 companies and individuals. Gray, ablaze with indignation and alarm, rushed to Capitol Hill to show the tape to the House Banking Committee chairman, Rep. Fernand J. St Germain (D-R.I.). Another screening was held at the Bank Board for Paul A. Volcker, chairman of the Federal Reserve Board.

Banning Blain would help avenge FSLIC, but Gray wanted the scalp of a regulator. He turned his wrath on Joe Settle, president of the Home Loan Bank of District 9, which included Texas. A genial North Carolinian, Settle had spent 17 years in the commercial banking world before being recruited in 1979 to supervise the thrift industry in the Southwest. For several years, the Bank Board members had considered Joe Settle to be weak, but well-meaning; now Ed Gray looked on him as the personification of regulatory myopia.

"The man is not a regulator," Gray fumed during a Bank Board strategy session. "He's got to go."

Although Settle had been appointed by the District 9 directors, Gray effectively controlled the job because the district presidents also served as "principal supervisory agent," responsible by law to the Bank Board chairman. On April 14, precisely one month after Empire fell, the three Bank Board members summoned Settle—without telling him why—to Monterey, Calif., where they were attending a meeting. The unsuspecting Settle walked into a conference room at the Hyatt Hotel, where he found Gray and board members Mary Grigsby and Donald Hovde waiting for him.

"We're not satisfied with the supervisory functions going on in your district," Gray said bluntly. "We've decided to replace you."

Settle, stunned and heartsick, managed to ask, "It's only because of Empire, isn't it?"

"No, no, no, no," Gray quickly replied. "I specifically looked at other cases, too."

The sacking of Joe Settle—the first district bank president to be dismissed in 50 years—sent shock waves through the Home Loan Bank system and the Southwest thrift industry. Texans in particular had trouble understanding what Settle had done to deserve such treatment; he had always been a regulator the thrift executives considered to be fair and sympathetic. Many of his admirers believed that he was being scapegoated for shortcomings that could just as easily be laid at Gray's door. Settle himself couldn't believe the way he was being treated by the man he'd helped tutor in the intricacies of the S&L business; despite Gray's heated denials, Settle later asserted that he had twice mentioned Empire's troubles to the chairman.

The firing carried a clear message, which Gray promptly reinforced by rebuking the Dallas board of directors and demanding that they replace Settle with Gray's candidate, an Arkansas-born thrift executive named Roy Green.

'You're Going Too Far'

Gray's new assertiveness didn't sit well at the district bank. He and Robert D. Mettlen, the District 9 chairman, held a vitriolic cussing match over the telephone, which they continued in person by swapping four-letter unpleasantries in a hotel banquet room the next time they met.

"You can send me any name you want," Gray insisted, "as long as it's Roy Green's." Mettlen and the other Dallas board members eventually relented and Green arrived in Dallas that September.

If Gray could impose his will within the fiefdom of the bank system, he nevertheless found himself eating humble pie on Capitol Hill. With increasing frequency, congressional committees summoned him to explain why the U.S. government was facing the loss of millions, if not billions, of dollars. Publicly raked over the coals, first by the House Government Operations Committee, then by the House Energy and Commerce Committee chaired by Rep. John D. Dingell (D-Mich.), Gray returned to his Bank Board office humiliated, furious and determined to act.

Those working at the Bank Board and in the district banks agreed that something was happening to Ed Gray. "You've read the New Testament? Read the Apostles?" one regulator explained years later. "Ed Gray was Saul on the road to Damascus and when Empire went down it was like a bolt of lightning knocking him off his horse. When he got up off the ground, he got up as St. Paul, a zealot."

Every few weeks, another thrift toppled into insolvency. Usually the staff delivered the bad news to the Bank Board members late on Thursday afternoons, with the actual closings conducted on Friday. "I was tired of getting that knock on the door late on Thursday," board

member Hovde later recalled. "Knock, knock, knock. 'We got another one.'"

By December 1984, 15 S&Ls had gone down, with assets of \$1.45 billion. Particularly alarming was the collapse of San Marino Savings in California. At a cost to taxpayers of more than \$200 million, San Marino represented a bigger loss than Empire. Gray was beginning to realize that California thrifts, which held roughly one-third of the industry's \$1 trillion assets, included many S&Ls that were just as precarious as some in Texas. In Sacramento, the state regulatory commission had been eviscerated in the early 1980s and the legislature had adopted new laws permitting a state-chartered thrift to invest money in whatever enterprise struck its fancy, with deposits still guaranteed by FSLIC. In a two-year period, California had received more than 200 applications for new thrift charters, and more than a few were heading for catastrophe.

With increasing clarity, Gray and his staff recognized that Empire Savings was not an anomaly. Certain patterns of reckless behavior had become commonplace and repetitive, as though lousy deals were being punched out all over America with a cookie-cutter. Often, a strong individual would gain control of a thrift and quickly dominate a weak board of directors. Record-keeping grew shoddy, internal auditors turned a blind eye, and regulators found themselves overmatched.

Honest S&L executives occasionally ran into trouble for emulating the high-rolling lending practices of their imprudent competitors, a phenomenon known at the Bank Board as the "me, too" syndrome. But it was the dishonest and imprudent thrift owners who posed the biggest danger because of their ability to expose FSLIC to billions in losses. The prevailing mentality in Texas showed up in popular bromides, such as "A loan repaid is money lost forever" or "A rolling loan gathers no loss." Another Texasism described the practice by which several thrifts traded worthless assets back and forth to camouflage the S&Ls' true financial condition; this was known as "trading dead cows for dead horses."

Ed Gray, increasingly anxious to take action, felt himself fettered by his own timid enforcement officers and attorneys. Seizing control of a private institution required proof of insolvency or reckless behavior, they argued, and losing in court could set a disastrous precedent that would sap the Bank Board's power. Gray, a non-lawyer surrounded by lawyers, focused his attention on drafting regulations that would apply a brake to the runaway thrift industry.

After only a year in office, Gray also felt a growing sense of isolation at the Bank Board. Beyond his inner circle in the bank's executive suite and a few stalwart friends such as Paul Volcker, the chairman's coterie of allies seemed to be shrinking. Members of Congress harassed him, the district banks eyed him warily, and growing portions of the thrift industry saw him as a "re-regulator," bent on imposing restraints that had been lifted earlier in the name of deregulation.

When Gray proposed new rules in December 1984 to sharply limit the kind of investments permitted an S&L, William O'Connell, president of the U.S. League of Savings Institutions, called. "Ed, you're going too far," Gray quoted O'Connell as saying. "There's only so much the industry can take at one time. If you do this, you're really going to hurt your career." O'Connell, who vigorously supported a number of Gray's initiatives, said recently he did not recall this episode.

Gray's colleagues in the administration began to look askance, wondering whether he had abandoned President Ronald Reagan's vow "to get government off the backs of the people." Gray had intimate ties to fellow Californians who had followed Reagan to Washington, such as Edwin Meese III. But many of the Californians had left government service, and Gray often had no common ground or clout with their replacements.

A particularly contentious issue involved Gray's plan to beef up his poorly paid, under-trained cadre of examiners; Gray figured that to cover the nation's 3,300 thrifts he needed to more than double the examination force, to about 1,500 positions. But that cost money and smacked of re-regulation. The plan ran into immediate opposition at the Office of Management and Budget (OMB), where some officials believed that Gray had failed to get the most out of the examiners he had.

As in the battle over "brokered deposits," Gray wheedled, exhorted, pleaded. This time, he also schemed. If he could pluck the examiners from the civil service and transfer them to the 12 district banks, they could earn more money, work hand-in-glove with supervising agents, and sidestep OMB's hiring ceiling because they would no longer be federal employees.

After peddling his plan to the examiners and

vigorously cultivating support in the districts, Gray met OMB Associate Director Constance J. Horner in the White House mess one afternoon in the spring of 1985. Horner declines to discuss the episode, saying she has only vague recollections of her dealings with Gray and the Bank Board, one of 30 federal agencies with which she dealt.

According to Gray's account of their conversation, Horner told him: "You are violating the policies of this administration, Ed. You are re-regulating and taking these people from the control of the president. You want to add more examiners, when our policy ought to be fewer examiners."

Gray scoffed. This was precisely the sort of ideological looniness he had come to expect, a knee-jerk faith in the mystical power of laissez faire—even when the U.S. government was holding the bag for a trillion-dollar industry. "Are you kidding?" he told Horner. "You know who you're going to hurt? The president. Doesn't anybody care about the taxpayers of this country?"

Gray's Choice

By securing grass-roots support in the districts and outmaneuvering OMB, which could hardly argue effectively against a plan to cut the federal payroll, Gray won the battle of the examiners. He moved the force out of Washington on July 6 and eventually doubled it.

But he wondered whether he was losing the war. Physically and mentally weary, he began contemplating resignation and a return to California.

Donald T. Regan, the White House chief of staff, thought that would be a good idea.

For Ed Gray and Don Regan, who met at the dawn of Ronald Reagan's presidency, it was dislike at first sight. Though both were gregarious, hail-fellow-well-met extroverts, the cultural chasm separating them was enormous. Gray realized that he appeared to embody the California pol, a public relations hack who had ridden Ronald Reagan's coattails for 20 years. Regan was Wall Street incarnate, evincing a disdain for the coddled, inefficient thrift industry.

From his days as a White House domestic policy adviser in 1981 and 1982, Gray had concluded that Regan viewed savings and loan associations as dinosaurs in double-knit, facing extinction under the glorious Darwinism of a free market. Gray recalled a conversation in August 1982, as he was leaving his White House job. "I'm not sure you're a team player," suggested Regan, who then was Treasury secretary. "You don't have to tell me about being a team player," Gray retorted. "I go back with Ronald Reagan since 1966." Not until he was stalking away, angry and offended, did Gray conclude that the secretary was talking about his team, not Reagan's.

In the summer of 1985, Gray began hearing through the grapevine that Regan wanted him out of the Bank Board. Regan still viewed the board as a captive of the industry it regulated and Ed Gray as a lightweight with little financial acumen. An informal search for a new chairman was launched, and there was talk of a sinecure for Gray, perhaps an ambassadorship. "This comes at an awful time for me," Gray told his old friend, Ed Meese, "because I wanted to leave anyway." Gray passed the word that he would go quietly if Regan promised not to gloat.

On Sept. 30, at 10 a.m., Gray walked into the West Wing of the White House to see Ed Rollins, another Californian who was leaving government service and who shared Gray's distaste for Regan. Rollins advised Gray that the chief of staff had renewed his efforts to find a new chairman. "You do whatever you want to do, Ed," Rollins recalled telling Gray, "but Don Regan wants you out. And I'm sure if he wants you out, he gets you out eventually."

Two weeks later, on a Friday night, a reporter called Gray and told him that she understood "on the highest authority" that he was announcing his resignation the following Tuesday. "You've got to be kidding!" the chairman replied. Hanging up, he muttered to himself, "It's that damned Don Regan and his twerps at the White House."

Gray counterattacked, leaking a story to the New York Times that made clear he wasn't going anywhere. Within a few days, a White House spokesman was assuring reporters of the president's foursquare support for his Bank Board chairman.

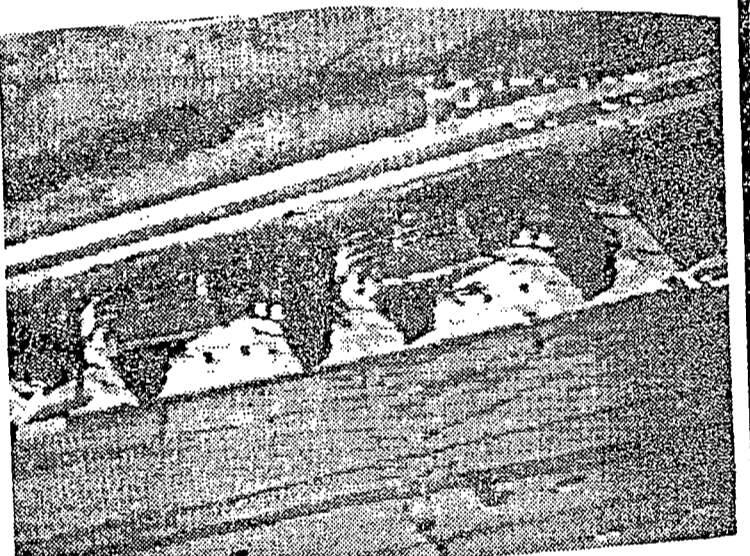
Nearly two years earlier, Ed Gray had dimly recognized that he had a choice to make: He could either remain a patsy of the industry or he could try to become the kind of regulator he knew the industry—and the nation—needed. Now, he realized, he had made that choice. Going home to California would have to wait. His job in Washington was not finished.

Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.

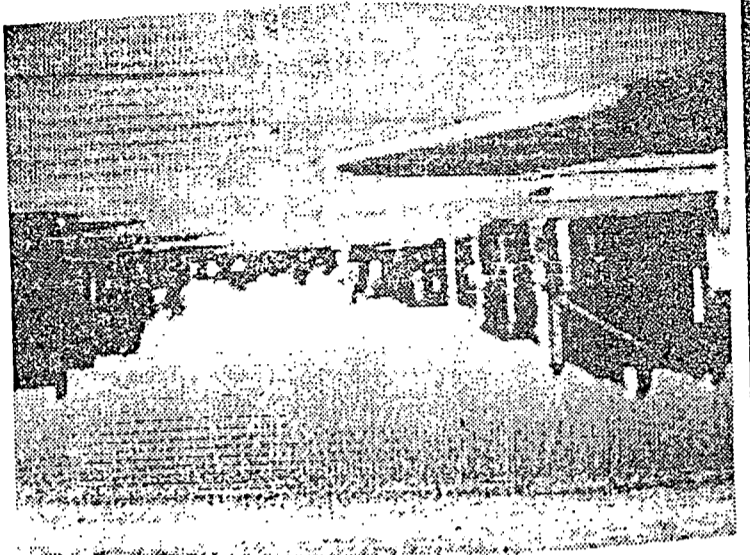
NEXT: The showdown

THE VIDEOTAPE

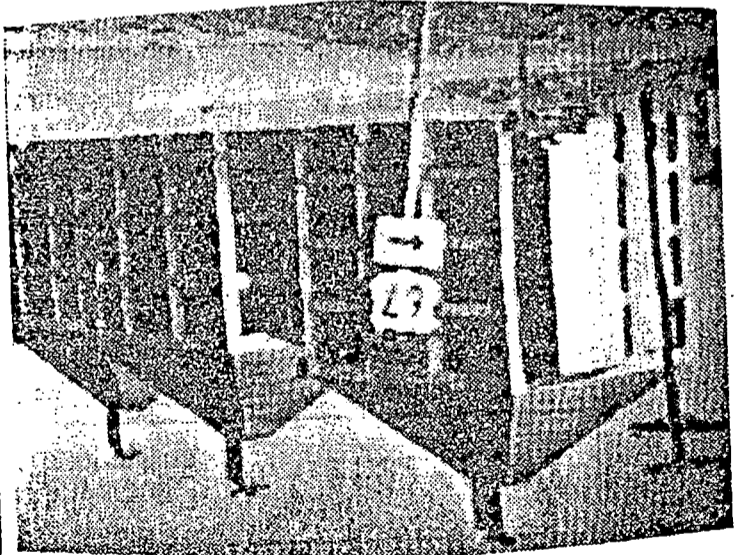
These are frames from a videotape prepared by a consultant for the Federal Savings and Loan Insurance Corp. to illustrate the financial plight of Empire Savings and Loan of Mesquite, Tex. The tape's contents—later characterized by Bank Board Chairman Edwin J. Gray as fiduciary pornography—helped persuade the board to declare the thrift hopelessly insolvent and order it closed.



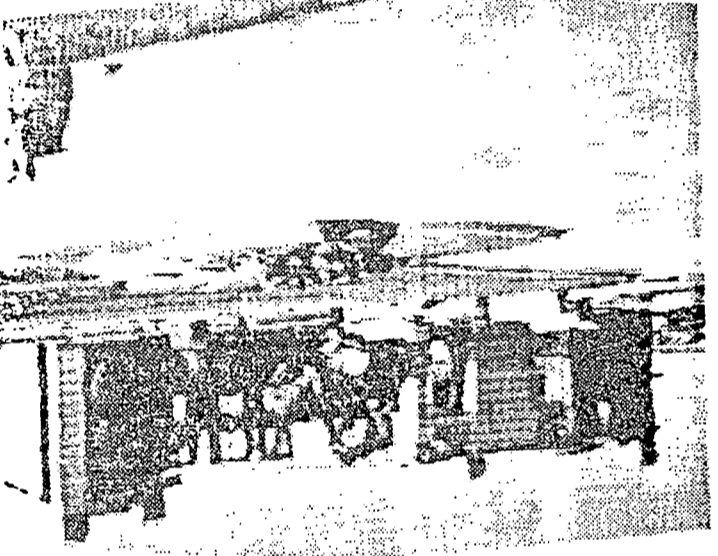
Notice the extremely high density



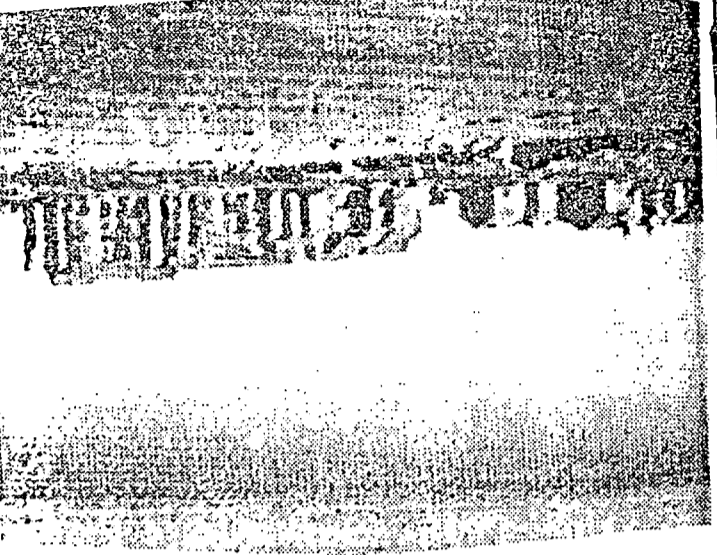
Virtually all vacant



No sales effort, no leasing effort



Evidence of arson



And the land is being prepared for more construction

Hardening the S&L Battle Lines

'You Can't Restrict Our God-Given Right to Make Profits!'

By David Maraniss and Rick Atkinson
 Washington Post Staff Writers

Edwin J. Gray was changing so fast during the closing months of 1985 that to follow him week to week was like watching a high-speed nature film: The bud blossoms into a flower, the tadpole becomes a frog. In this case the human metamorphosis was from optimist to cynic, congenial publicity agent to obsessed reformer.

All the romantic notions Gray once held about the savings and loan industry were evaporating as more thrifts plunged toward insolvency. Shannon

Fairbanks, his chief of staff, could see that he was becoming an active, even hostile, regulator. Gray had a tendency to view the world in simple terms, good and bad, Fairbanks thought, and the thrift industry had fallen into his bad category. The devastation wrought by Empire Savings and Loan in suburban Dallas had sparked a fire in him that could not be put out. Attempts by White House Chief of Staff Donald T. Regan to force him off the Federal Home Loan Bank Board only doubled his sense of self-righteousness.

Feeling isolated and abandoned, Gray often

worked late into the night at his headquarters one block from the White House. A siege mentality gripped the Bank Board. Gray posted a guard at the fifth-floor elevator to stop intruders who might slip past the security desk downstairs. Behind closed doors, he bickered endlessly over policy issues with the two other board members, Wisconsin real estate developer Donald Hovde and former Texas thrift executive Mary Grigsby. On one occasion, the exchange grew so heated that Gray locked his office and refused to admit Hovde, who was reduced to slipping notes to the chairman under the door. Grigsby, who had enduring ties to Texas, felt uncomfortable enough in the role of tough regulator to puckishly don a Groucho Marx disguise during a visit home.

Though sharing his views on the burgeoning savings and loan crisis, Gray's staff considered him autocratic, "a pill to be around," as one put it. He became ever more anxious and obsessed, particularly after Fairbanks—who had long absorbed some of the stress for Gray—was found to have cancer. Returning to work after surgery, Fairbanks brought a new outlook: Do what you can and don't worry about it. "Let it go," she would tell her boss. "Let it go."

But Gray could not let go, any more than his enemies in Texas could.

Ever since Gray had fired Joe Settle, the top regulator at the Federal Home Loan Bank of Dallas, many Texas thrift executives believed Gray had it in for them. His interference in the regional regulatory process, his efforts to restrict "brokered deposits," his move to impose growth restrictions—all appeared to them as vindictive attacks on the Texas entrepreneurial ethic. Instead of shutting down the worst parts of the industry, Gray seemed determined to strangle every thrift in Texas.

"You can't restrict our God-given right to make profits!" Texas thrift lobbyist Durward Curlee complained to Fairbanks in Dallas one day.

Trying to steer a middle course between the federal regulators and the Texas industry was L. Linwood Bowman III, the state S&L commissioner. A former thrift executive from the northeast Texas town of Greenville, Bowman couldn't understand Gray's *Us v. Them* view of the world. He had joined the Texas Savings and Loan Department in 1980, eager to find "a nice quiet little job with little controversy," and two years

later he ended up as commissioner. Bowman used the pronoun "we" interchangeably in describing his S&L department and the industry it was supposed to regulate; he regularly played golf and socialized with thrift executives, partly out of a conviction that he could keep tabs on them that way.

Not that Bowman turned a blind eye to the problems around him. He was, after all, the first to warn Ed Gray of the troubles at Empire, the first to decide that the only way to curb Empire was to take control of it, the first to take action against some of the industry's high rollers. But Lin Bowman was a man beset with second thoughts. As he moved against Empire and its powerful owner, Spencer H. Blain Jr., Bowman had been riddled with uncertainty, puzzled by the difficulty in distinguishing mismanagement from entrepreneurial wizardry. "What if I'm wrong," he asked himself, "and he's right?"

The hardest part of serving as commissioner, Bowman said later, was "waking up every morning and bringing myself to the level of arrogance where I was certain I was right."

A Branch on the Moon

Bowman's self-doubt was aggravated each time he ventured from his Austin office into the streets of the Texas capital. In every direction, the sights and sounds of prosperity appeared to confirm the seemliness of go-go development. By late 1985, Austin had replaced Houston and Dallas as the real estate gold mine of the Southwest. Office buildings along the main thoroughfare, Congress Avenue, rose so fast that each month residents lost another view of their splendid, pink-granite Capitol. To slow-growth advocates, the situation seemed out of control; one lawyer, not realizing the prescience of his words, suggested that the best brake would be "to put the whole city in receivership." But to financiers, Austin was heaven.

And on its way to the heavens as well. At least that was the scheme of Stanley E. Adams, owner and chief executive of Lamar Savings Association, the fastest-growing thrift in Austin. Slow-talking and mysterious, an Orson Welles of a man, Adams conceived of the ultimate symbol for highflying Texas thrifts: He filed for permission to open a branch office on the moon. "It's got to be one of the best p.r. stunts of the decade," he boasted. Adams even picked out a site, noted on the application form submitted to Lin Bowman: Cayley Crater in the Sea of Tranquility.

"What the hell," Adams told Bowman when they met to discuss the venture. "They laughed at da Vinci, too."

Bowman sighed. "Aside from being a laughingstock," he replied, "I think we've got a jurisdiction problem. Since when did I get jurisdiction for the moon?"

If the lunar application suggested a certain sky's-the-limit ethic in Texas, Stanley Adams was an outsized embodiment of the state's pioneer spirit. Even when his ambitions remained earthbound, Adams thought big: He began negotiations to build the tallest skyscraper in China, a 62-story office tower at the Canton Trade Center. And, with lobbyist Durward Curlee and other investors, Adams planned a mind-and-body fitness center in Austin where executives could "take a holistic approach to mental fitness where your brain learns to accept unreality as real," in Curlee's words.

That concept already seemed well established in the savings and loan industry of Texas.

The rise—and subsequent fall—of Lamar Savings illustrated two characteristics at the heart of the savings and loan calamity. The first was a tendency by dozens of Texas thrift operators, contemptuous of government bureaucrats, to push beyond the limits of prudence. The second was the revolving-door relationships between regulators and those they were supposed to regulate.

Beginning in 1982, Adams had pushed Lamar into the real estate and construction business, convinced that was the key to survival in a mercurial financial world. Lamar bought two development companies, established a "national money desk" to lure brokered deposits, and shifted Lamar's portfolio away from the home loan mortgage business that had been its bread and butter for three decades.

In 1985, the remaking of Lamar appeared to be a stunning success. Adams toiled around Austin in a new Maserati, quadrupled the average salary of his executives and provided them with a fleet of 80 luxury automobiles—Lincolns, BMWs, Maseratis.

But federal regulators saw signs of trouble. Some of Lamar's real estate loans soured. The thrift's capital reserves, intended to cover the losses, began to dwindle. S&Ls were supposed to have capital—either cash or investments that could be converted to cash—equivalent to at least 3 percent of their deposits. Lamar's reserves, examiners discovered, had slipped below 2 percent.

On June 19, 1985, Lamar received a warning letter from the Federal Home Loan Bank of Dallas, notifying the thrift that the regulators would seize control of Lamar unless its capital reserves improved. "Instead of taking remedial steps," the government charged in a subsequent lawsuit, Lamar's executives "stepped up their efforts to deceive."

Between late June and December, Lamar bolstered its capital by going on a lending spree, taking in large fees at the front end of each loan. During three days in late June, for instance, the thrift closed seven loans for more than \$132 million, nearly twice the total for the year until then. By December, 64 deals had been executed, and Lamar was able to report a capital-to-net-worth ratio above the minimum 3 percent level.

This dramatic turnaround, federal regulators later charged, "had no basis in reality." Of the 64 deals, 60 borrowers went bankrupt, defaulted or hinted at defaulting. The transactions, federal officials said, involved numerous "unsafe" practices. Lamar's managers, the regulators concluded, seemed unconcerned about whether the borrowers could repay.

In the midst of this financial turmoil, Lamar displayed the kind of incestuousness between regulators and regulated that had become commonplace in the Texas thrift industry. From January 1983 to July 1985, Lamar's board of directors included University of Texas finance professor Robert Mettlen, who also served as chairman of the Federal Home Loan Bank of Dallas. For several months in 1984, the president of Lamar was Joe Settle, the Dallas Home Loan Bank president who had been fired earlier that year by Ed Gray. One of Lamar's stockholders was Dick Jameson, chief of supervision for the Texas Savings and Loan Commission.

Perhaps the paramount example of the revolving door involved Lamar's internal auditor, the man who reviewed audits and appraisals and served as the thrift's liaison to state and federal regulators. Felix Charles Rheams began his professional career in 1963 as branch manager for a San Antonio thrift; he lacked both a college degree and formal training as an accountant, neither of which was required for the job. Five years later he went to work for the Federal Home Loan Bank as an examiner in Texas.

Adams, whose S&L was one of those Rheams examined, hired him away from the government in 1982, rewarding the new employee with a Lincoln Town Car, a \$40,000 bonus and, eventually, a promotion. "Mr. Adams walked into my office one day and told me he was going to make me executive vice president. And I said, 'What for?' And he says, 'Well, I know you don't like titles, but I want you to be executive vice president.' I said, you know, 'You're the boss,'" Rheams later recounted in a deposition.

The promotion was short-lived. In June 1986, federal regulators finally seized control of Lamar, displacing Adams and firing Rheams.

Where did Rheams find employment next? With the Federal Home Loan Bank Board—as an examiner. In February 1988, the federal government filed a civil suit against Adams and other former Lamar officers and directors, alleging that they had conspired to deceive the regulators. Among the defendants was Felix Charles Rheams. Only then did government officials realize that he was on their payroll. They fired him, again.

When the suit was filed, Adams said he welcomed it. "We'll be able to see where the real mismanagement, misappropriations, dissipation of assets, fraud and conspiracy lies," he said.

Late in the fall of 1985, as Stanley Adams was trying to hold on to his thrift, Ed Gray and his senior staff at the Bank Board were coming to grips with the magnitude of the crisis facing them. The Federal Savings and Loan Insurance Corp. (FSLIC) was losing money at a rate that would soon lead to its own bankruptcy, and the industry had savaged Gray's plan to replenish the fund through a one percent fee on deposits.

On Oct. 18, during a joint meeting of the Dallas and Atlanta district banks at Bishop's Lodge, N.M., Gray asked for suggestions. George Barclay, then a vice president at the Dallas bank, offered a plan that would raise \$15 billion, mostly through the sale of government bonds—enough to allow FSLIC to shut down the growing number of insolvent thrifts and guarantee that depositors wouldn't lose any money. Gray liked the idea. For the next month Barclay and representatives from the 11 other regional banks refined the plan.

On Nov. 20, Barclay and Roy Green, president of the Dallas bank, flew to Milwaukee to pitch the concept to a critically important audience—a subcommittee of the U.S. League of Savings Institutions, the primary thrift trade association. Several industry executives pelted Barclay with hostile questions. You're exaggerating the crisis, they said; if you regulators had done your job right in the first place, there wouldn't be any problem. Then the U.S. League staff offered data showing that some credit unions and banks were in as much trouble as S&Ls. One senior executive suggested that the best course was a government bailout of the whole financial community.

'Come to Jesus'

The hostility intensified. One California thrift executive said he would not contribute "one more nickel" to help FSLIC. Milwaukee S&L owner Gerald J. Levy, newly installed president of the league, was particularly angry. He had just looked at computer printouts showing frenzied growth by many Texas thrifts, despite new Bank Board regulations—supported by the U.S. League—that supposedly restrained such expansion. These Dallas regulators, Levy thought, had the gall to propose drastic, nationwide solutions when they couldn't even control the problem in their own backyard. Levy vowed to "drive a stake into the heart" of the Dallas plan.

"Damn, did we get hammered," Green told Barclay as the two rode back to the airport. "This thing is dead."

Back in Dallas, Green and Barclay soon saw signs that the once-booming Lone Star economy had taken a turn for the worse. Oil, which had sold for \$24.53 a barrel in December 1985, would plummet to \$9.39 by May 1986. Foreclosure became a common word in Texas. Though no one then realized how profound the depression would get, one thing was immediately obvious: Developers, aided by the savings and loan industry, had gone wild during the boom. Houston and Austin had so much surplus office and housing stock that city officials feared it would take at least 10 years to fill the vacancies.

Real estate loans that once looked good now looked shaky. Those that had looked shaky now looked hopeless. Under new Bank Board regulations intended to show a more realistic picture of an S&L's financial health, regulators classified loans as good or bad not on the basis of collateral that might be received in foreclosure, but on the borrower's ability to repay. That was a tougher standard, one that imperiled scores of thrifts.

Supervisors in the Dallas bank held what they called "come to Jesus" meetings. During these emotional sessions of denial and recrimination, the regulators tried to get executives of insolvent S&Ls to "see the light and surrender the keys" to their thrifts, and thus avoid a protracted court battle. Among those who dropped his keys on a supervisor's desk in Dallas was Stanley Adams, the apostle of lunar branching.

One day in February 1986, Ed Gray's enforcement chief came to him with the bleakest news yet. Reports from the field based on the new loan classification rules showed that Texas was a disaster zone, with a number of thrifts in trouble. Regulators in Dallas couldn't begin to keep pace with the problem.

Gray called a meeting of his 12 regional bank presidents and asked 10 of them—the San Francisco office had enough problems of its own—to speed relief troops into Dallas for a six-week examination blitz. On March 20, 250 examiners arrived and began poring over the books of nearly every S&L in the Southwest. The discoveries were mind-boggling: mismanagement, fraud, losses in the billions.

The examination force—widely disdained in Texas as Ed Gray's carpetbagging "get Texas" squad—was a start, but it wasn't enough. Roy Green, president of the Dallas bank, realized he needed more than temporary help. He needed a tough, experienced chief of supervision to pound the Texans back into shape. In Washington, in the federal agency that regulated national banks, he found his man. They called him the Hammer.

NEXT: Sending a message

Staff researchers Elizabeth Hudson and Melissa Mathis contributed to this report.

THE \$150 BILLION CALAMITY

Fifth of Seven Articles

**Putting the Hammer
To Lone Star Thrifts**By Rick Atkinson
and David Maraniss
Washington Post Staff Writers

DALLAS

Harry Joe Selby hardly cast an imposing shadow when he walked through the double doors of the Federal Home Loan Bank of Dallas on May 1, 1986. Plump and pink-cheeked, with snow-white hair and a fondness for bird-watching, he had a milquetoast demeanor that belied the image of the Hammer—which is what he called himself—and the Angel of Death, which is what his many enemies would soon call him.

Yet Joe Selby was a man with a mission: to restore law and order to the savings and loan industry in the Southwest. After 32 years serving the federal agency that regulates national banks, he had agreed to leave Washington to become the chief federal thrift regulator in Texas and the four other Sun Belt states of District 9.

Dallas appealed to Selby for two reasons. The first was money. Rejecting an offer of \$150,000 a year—twice his salary in Washington—he held out for \$165,000. Both Roy Green, the Dallas Home Loan Bank president who had recruited Selby, and Edwin J. Gray, the Federal Home Loan

Bank Board chairman, considered the deal a bargain. "I want to send a message to Texas that we mean business," Gray told his staff. Joe Selby, the Hammer, would be the messenger.

The other factor influencing Selby was the chance to return to his native Texas. He had grown up in Ganado, one of a string of villages—most featuring women's names—along Highway 59 in the oil and cattle country of the gulf plains. Traveling salesmen, Selby joked, liked to spend the night in Ganado so they could boast of sleeping between Edna and Louise. Selby's father, a prominent burgher who owned the local bank, often took young Harry Joe along to banking conventions. By the time his son was in seventh grade, the senior Selby had put him to work, first at the dreary task of filing canceled checks, later as a part-time teller on Saturdays when the cotton farmers walked in to deposit their weekly earnings.

At age 55, Joe Selby had come home. Although an expert on banks, he knew little about the savings and loan business; he knew even less about the industry in Texas, except that it had grown 1,200 percent in the past quarter-century. Before leaving Washington, he had heard of only one specific thrift in all of District 9. "You've got an institution down there," a banking acquaintance said one day, "called Vernon Savings. I hear they're over in Taiwan soliciting deposits." Puzzled but intrigued, Selby tucked the information away for future reference.

As he settled into the cramped temporary office assigned him on the third floor of the Dallas bank, he also was puzzled by the rumors that had preceded his arrival. The Joe Selby being whispered about by anxious thrift executives was a 10-foot-tall bogeyman with fangs, bent on destroying their industry.

Selby liked the image, hoping to put it to good use. "This is probably the best thing that can happen," he assured Roy Green. "I'm going to be the bad guy, cleaning up the system, getting rid of the crooks." You, he told Green, can be the good cop to my bad cop; we'll make a terrific team.

'Let God Sort 'Em Out'

There were, to be sure, disquieting portents. Selby was astonished to find that his examiners not only lacked computers, they even wanted for typewriters. Despite a \$30 million annual budget for regulatory activities in District 9, all 300 examinations then under way were scratched out in pencil and carried to a typing pool, just as they had been in the 1950s.

Selby also found that the bank was undergoing a \$12 million renovation. The place was bedlam. Scores of workers were adding a wing, complete with five-story garage, child-care center and health club; other workers clumped about the old building, noisily bolting new granite facing to the walls and installing a sprinkler system. Consultants and lawyers besieged the bank, selling their services whenever another thrift tottered toward insolvency.

Most alarming to Selby was the prevailing coziness between the savings and loan industry and regulators. Banks and thrifts, he soon concluded, were different creatures. Bankers would not dare refer to the federal insurance fund as "our FDIC" as thrift owners referred to "our FSLIC." Selby was appalled to learn that some Dallas supervisors had accepted mortgage loans from institutions they were overseeing. He also had the bank's general counsel fire a barrage of conflict-of-interest warning letters to former regulators who had quit the Dallas bank so they could take jobs with the Texas thrifts they once supervised.

Selby, soon working 12 to 15 hours a day, helped establish a triage system that gave priority to the sickest of the sick thrifts. Examiners evaluated a thrift's health on a 1-to-5 scale, but the system had become almost meaningless because a majority of Texas savings and loans now rated an unhealthy 4 or 5. (By March 1987, 191 S&Ls in District 9 would be classified as 5s.) Determined to send his own message to the industry, Selby created an "investigation unit" with a half-dozen gumshoes assigned to work with the U.S. attorney and Federal Bureau of Investigation. "We need to put somebody behind bars," he demanded again and again.

He urged his regulators to be tough-minded, aggressive. Gone were the days when a regulator could assume that if a questionable practice wasn't specifically forbidden, it was therefore permissible. Ed Gray's new rules for evaluating an S&L's true financial plight had to be applied rigorously, Selby insisted.

Equally frustrating for Selby was the pedestrian pace of state regulators, who often resented the feds for their imperious manner and apparent presumption that a Texas regulator was an inferior species. Selby shared the view, prevalent at the Bank Board in Washington, that the Texas Savings and Loan Commission had long been an underpaid, understaffed handmaiden of the industry. Yet he couldn't help but like the gregarious commissioner, L. Linwood Bowman III; Selby laughed heartily when Bowman presented him with a black T-shirt, inscribed "Kill 'Em All and Let God Sort 'Em Out."

To many thrift industry executives, Selby indeed seemed determined to "kill 'em all." Their initial whippers of alarm turned into rancorous maledictions. Selby was viewed as vengeful and arbitrary, "sinking ships to get the captains," as one former S&L executive put it.

One afternoon in the late summer of 1986, the telephone went dead at the home of supervisory agent Bill Churchill. When a repairman arrived, he found a three-inch black box clipped to the line outside; the device was a transmitter—a bug—that had malfunctioned and caused the phone to stop working. The matter was reported to the FBI, but never resolved. (A more ominous incident occurred earlier when a gunman shot out the windshields of two unoccupied Chrysler LeBaron station wagons owned by the Texas S&L Commission and parked outside the agency's suburban Dallas office. Local police investigated, to no avail.)

After discovery of the Churchill bug, the Dallas bank conducted regular sweeps for listening devices in the bank and at the homes of Selby, Roy Green and other senior officials. An elaborate security system was installed at the district bank, along with new procedures for entering and leaving the building after hours.

Bank officials began to worry about more sinister threats—particularly after hearing rumors of a plot to kidnap Selby. A security firm installed expensive burglar alarms in the homes of the bank's top executives. The systems included intruder detectors, special phone lines that notified police if the line was cut, and small, portable "panic buttons" that would trip an alarm if pushed. Keep one button hidden near the toilet in your house, the security consultants advised, since most kidnapers will let you use the bathroom before abducting you.

Only a few months after returning home, Joe Selby began to have second thoughts about the benefits of being the federal bogeyman, the "bad cop," the Hammer. The stakes—billions of dollars—were enormous

enough to compel desperate men to act desperately. What, he wondered, have I gotten myself into?

'Long Days and Hard Work'

Within weeks of his arrival in Texas, Selby began hearing a great deal more about that thrift supposedly peddling its services in Taiwan: Vernon Savings and Loan. What was happening at Vernon had happened in Texas and elsewhere a hundred times with varying degrees of stupidity, misjudgment, fraud and bum luck. Regulators had a nickname for Vernon: They called it Vermin.

Vernon, Tex., is a town of 13,000, two hours northwest of Dallas. Originally called Eagle Flats, it once straddled the old cattle trail leading to Doan's Crossing, where 6 million beeves had splashed across the Red River. Renamed in honor of George Washington's home, Vernon now boasted, among other local industries, a factory outside town that stitched Boy Scout uniforms.

Vernon Savings, one of the town's two thrifts, was founded in May 1960 by R.B. Tanner, who had been a bank examiner during the Depression and knew the virtue of caution. For 22 years, the S&L lived within its means on the profits earned by making home mortgage loans in Wilbarger County. In January 1982, Tanner sold out to a local boy turned Dallas real estate developer, Donald R. Dixon, son of Vernon's newspaper publisher. Promising to give something back to the community, Dixon took control of the \$83 million institution by putting up \$1 million in cash and another \$4.7 million in promissory notes.

Dixon expanded Vernon full bore. He moved the main office to Dallas and lured new deposits in the form of "jumbo" certificates of deposit—\$100,000 each—with high interest rates. He promoted his thrift aggressively; in 1983, one of Vernon's ads bested 750 competitors to win a national advertising prize. The winning entry showed a photograph of a Stetson, cowboy boots and work clothes heaped next to a bathtub: "Relax. A relaxing end to a hard day. We all need that, especially when we're putting our best efforts into our work. Vernon Savings employees understand long days and hard work . . . Relax with that assurance." The ad prominently displayed the logo of the Federal Savings and Loan Insurance Corp.

Within four years, Dixon had increased Vernon's assets by more than 1,000 percent, to \$1.3 billion. He also increased Vernon's liabilities by 1,500 percent, according to Bank Board documents. In 1982-83, Vernon made \$700 million in construction loans in an effort to earn enough cash to pay the high interest it was offering on deposits. Dixon declined to be interviewed for this series. His attorney, R. Stan Mortenson, said criticisms of Vernon are made with "20/20 hindsight . . . Most of the problems here have to do with the regulators and the economy and overreaction."

In a pattern repeated by other highfliers, according to federal officials, Vernon often took all the risk by financing not only the purchase price of the land and construction project, but also closing fees and future interest costs. It frequently skimped on collateral, as in a \$24 million loan secured by a 99-acre tract, one-third of which was underwater, according to Bank Board documents. By 1985, the Bank Board documents conclude, 70 percent of the thrift's interest and fee income was "self-generated." In other words, Vernon was paying itself.

Vernon paid itself in other ways, too, as later documented by Bank Board investigators. The S&L bought a hunting club and three beach houses, including the \$2

million Del Mar "cottage" in California where Dixon and his wife lived for 18 months, running up a \$761,000 entertainment and expense tab. Vernon spent \$6 million for a fleet of five planes and six pilots, the so-called Vernon air force. Another \$5.5 million went to buy artworks for the thrift's offices.

The conspicuous consumption included pleasures of both palate and flesh: a two-week, \$22,000 "Gastronomie-Fantastique" dining spree through Europe; the flying of comely young women to board meetings in California for "sexual payoffs" that eventually led to the bribery conviction of a Vernon vice president, and the purchase of a luxury yacht, the *High Spirits*, which often plied the Potomac, carrying members of Congress and other officials who were wined and dined lavishly.

Vernon Savings also demonstrated how comfortably the foxes and chickens lived with one another in Texas. State S&L Commissioner Lin Bowman—who believed that proximity to thrift highfliers helped him keep tabs on them—had accepted a ride to California with the Vernon air force and had twice gone pheasant hunting in Kansas with Dixon. He also had an ongoing condominium development partnership—Cottonwood Investments—with Patrick G. King, who had left his post as state director of S&L supervision to work at Vernon; Bowman has defended the investment, which began when King still worked for the state, saying it did not influence his actions as a regulator.

Vernon also worked hard to conceal its financial shenanigans, the federal government alleged in a subsequent lawsuit. The thrift's books appeared "incomplete and in total disarray," with records deliberately distorted, the federal officials said. Vernon officers sold tens of millions of dollars in loan "participations" to other thrifts, thereby improving Vernon's financial picture by making it appear that other institutions shared some of the riskier investments; yet, according to a government suit, Vernon was able to peddle those participations only by secretly agreeing to buy them back later. Former Vernon officials have since contended that their actions would not have appeared imprudent had the Texas economy not gone bust.

Grounding the Air Force

Within a few months of Dixon's 1982 takeover, regulators began to pick up hints of Vernon's questionable practices. In November of that year, a federal examiner lowered Vernon's rating from 1 to 2, noting several rule violations and "loan documentation deficiencies." A state examination in January 1983 observed that Vernon was accepting virtually all of the risk in construction loans. Another federal exam in October 1983 downgraded Vernon to a 4, citing "unsafe and unsound lending practices." In August 1984, Vernon's directors promised to reform, but a year later, examiners found that 29 of the 31 reform agreements had been violated. "Out of control," the examiners wrote on Aug. 2, 1985, and slapped Vernon with a 5, the lowest possible rating.

That should have triggered immediate regulatory action, yet nothing happened. Somewhere between the examiners' red warning flags and the Dallas supervisors' responsibility for acting on those warnings, Vernon slipped between the cracks. "I wish I had a good answer to why we didn't do anything," one Dallas supervisor lamented recently. "Vernon didn't get the attention it should have. It was one of the herd, one of the many."

In late summer of 1986, Joe Selby entered the Vernon fray. He discovered that the thrift had a bonus

plan—euphemistically known as the "bean program"—that had paid Dixon and others nearly 5 million "beans." "Gentlemen," Selby declared in a meeting with several Vernon officials and his own regulators, "the bean program is dead."

Because Vernon was state-chartered, the Texas Savings and Loan Commission could, in some respects, move more quickly than its federal counterpart. In September, the state seized supervisory control of Vernon with a team headed by Deputy Commissioner Earl Hall. To make a statement about who was in charge, Hall moved into Dixon's former office but promptly tripped near the ornate desk and broke his leg. Hobbling about in a cast for six weeks, Hall tried to take command. He grounded the Vernon air force—"Fire the damned pilots!"—and refused to pay \$12,000 to international playboy Philippe Junot for services in arranging the *Gastronomie-Fantastique*.

Yet Joe Selby suspected that more radical action was necessary, perhaps a federal takeover—or closing the institution altogether. Vernon was hundreds of millions of dollars in the red, a staggering potential loss to the federal insurance program.

The debacle at Vernon Savings made Joe Selby angry. Many regulators had gone about their business determined to see, hear and speak no evil. As they used 1950s techniques—scratching reports with lead pencils—so they displayed a 1950s mentality. Selby was determined to bring them into the '80s.

But many in the Texas thrift industry saw things differently; Selby was willing to run roughshod over everyone, solvent and insolvent, innocent and guilty, autocratically dictating how their businesses would be run. To Durward Curlee, who lobbied in Washington for 20 Texas thrifts, including Vernon, Selby resembled a fireman who demanded to know who had been playing with matches before he'd fight the conflagration. "Joe Selby," another lobbyist complained, "wants to close up every association in Texas."

By autumn, Texans were looking to Washington for a redress of their grievances. On Oct. 21, 1986, House Majority Leader Jim Wright, the Texas Democrat who was about to ascend to House speaker, arrived for a luncheon meeting and gripe session at the Ridglea Country Club in Fort Worth. Wright expected perhaps 15 real estate and S&L executives to show up; instead, 150 awaited him. More than a dozen recounted tales of what they considered to be arbitrary and capricious actions by the federal regulators. Wright listened attentively and, as the luncheon drew to a close, publicly asked his friend and business partner, George A. Mallick, to draft a report outlining "the real story" on District 9's problems.

News of Wright's interest spread quickly and his Washington office was bombarded with phone calls from others eager to recount their "horror stories." On Oct. 23, two days after the Ridglea meeting, Wright met in San Antonio with W.W. "Bo" McAllister, president of the Texas Savings and Loan League.

"I am convinced," McAllister subsequently reported in the league's magazine, "that Congressman Wright is taking this issue very much to heart and is dead serious about insuring that Texas financial institutions are given every opportunity for survival."

NEXT: Dueling with the speaker

Staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.

THE \$150 BILLION CALAMITY

Sixth of Seven Articles

'Gray the Re-Regulator' And Wright Lock Horns

By Rick Atkinson
and David Maraniss
Washington Post Staff Writers

Ed Gray cupped the telephone receiver against his ear, nodding more in courtesy than agreement. For several minutes, the Bank Board chairman listened attentively, saying little beyond a few perfunctory "uh-huhs." He'd heard it all before: once again, House Majority Leader Jim Wright was complaining about how heavy-handed regulators were making life miserable for the savings and loan industry in Texas.

Chief of staff Shannon Fairbanks sat next to Gray's desk, eavesdropping on his end of the conversation. Calls from important members of Congress had become so commonplace that Fairbanks had worked out a routine for fielding them. As usual on this mid-November afternoon in 1986, she had walked into Gray's office, shut the door and announced that Wright was on the line.

Five minutes into the call, Gray's countenance changed. He stopped nodding. His features tightened. "No," he interjected. "I was the one who recruited him. I think very highly of him. He is doing what I want him to do. He is being a tough regulator."

Gray hung up and wheeled toward Fairbanks, his face flushed. "No way!" he declared. "No way!"

The chairman summoned several other staffers who listened intently as Gray poured out his version of the phone call: Jim Wright wanted Joe Selby fired. Wright, a Texas Democrat, had claimed that Selby, the hard-nosed chief regulator for the Home Loan Bank of Dallas, was homosexual,

and had established a "ring of homosexual lawyers" in Texas who got preferential treatment in handling S&L legal matters. "Isn't there anything you can do to get rid of Selby, or ask him to leave or something?" Gray quoted Wright as saying.

It was nearly 6 p.m., but Gray called the comptroller of the currency's office, where Selby had worked for 32 years before taking the Dallas job in 1986. Have you ever heard anything about Joe Selby giving special treatment to homosexuals? Gray asked. No, he was told, nothing like that.

Suddenly, Ed Gray felt dirty. He had grown accustomed to queries and complaints from Capitol Hill about regulatory matters. On occasion, he even brought district bank officials to Washington so they could explain to this congressman or that senator why actions had been taken against a particular thrift. Yet Wright's call, Gray thought, went too far, even for someone as persistently eager as Jim Wright to insert himself into the regulatory world. Congressional investigators later reached the same conclusion and recommended that Wright be charged with conduct unbecoming a House member; for his part, Wright denied asking Gray to fire Selby.

Just a month before this phone call, Gray had met with Wright to explain the dilemma the Bank Board faced: how the Federal Savings and Loan Insurance Corp. (FSLIC), which guaranteed deposits, was heading toward bankruptcy because of the rising tide of S&L failures; how the FSLIC fund had dwindled to \$2 billion, with hundreds of thrifts—holding nearly \$100 billion in additional deposits—in serious trouble; how regulators could not close even the most insolvent institution because the insurance fund was dangerously low.

But Wright, Gray was convinced, did not hear. Instead, he petitioned the Bank Board on behalf of his Texas thrift constituents, including Thomas M. Gaubert, whose Independent American Savings Association was nearly half a billion dollars in the red. Gray also believed Wright had demonstrated his displeasure with the Bank Board by blocking a bill that would have injected \$15 billion into FSLIC. Now Congress had adjourned and new legislation would have to wait at least six weeks until the 100th Congress convened in January 1987.

If Ed Gray felt dirty, he also felt exhausted. For nearly four years as chairman, he had fought one battle after another, against the thrift industry, against Congress, against his enemies in the Reagan administration. Aides noticed that his hands often trembled now; he seemed distracted, jittery, graceless under pressure, a far cry from the hail-fellow public relations executive who had come to the job four years earlier. Chain-smoking, Gray hunched over his Selectric III typewriter far into the night, pounding out his own speeches and congressional testimony, pausing only long enough to order a pizza for supper or dash out to McDonald's.

Hardly audacious by nature, he drew strength from his heroes. Winston Churchill was a particular favorite, and, alone at night, Gray often pulled out "History of the English Speaking People" or listened to tapes of the great statesman's speeches. Seeking a moral azimuth to guide himself, he often wondered, "How would Ronald Reagan make this decision?" As often as several times a week, he called Paul Volcker at the Federal Reserve for advice and sympathy, dragging on his cigarettes and pouring out his troubles while the Fed chairman worked his ubiquitous cigar at the other end of the line.

For someone with a public relations background, Gray managed to garner unbelievably bad press for himself. Shortly after Wright's call regarding Selby, thrift executives leaked word to the press that Gray enjoyed an imperial lifestyle whenever he traveled. That triggered inquiries leading to stories such as this one in The Washington Post: "Bank Board Lived Well Off S&Ls—Industry Picked Up Tab." Gray, for example, had stayed in a \$649-a-night room at the Waldorf Astoria. He and board members Mary Grigsby and Don Hoyde had run up a \$4,000 limousine bill in Dallas, as well as a \$5,000 hotel bill in California, all paid for by the industry through its financial support of the district banks.

The revelations humiliated Gray and damaged his credibility, further weakening his clout on the Hill and in the administration. How could he campaign against profligate thrift executives if he appeared profligate himself? While acknowledging his own mistakes, he railed against the industry for disclosing his travels, sounding so bitter that a close aide admitted he sounded "wacko . . . off the deep end."

To make amends, Gray voluntarily repaid \$28,000 in personal expenses. Supporting two homes, he mailed his paycheck to his family in California and lived alone in a small, \$500-a-month flat near the Bank Board. Increasingly strapped for cash, Gray raided his daughter's college tuition fund, borrowed \$15,000 from his mother, and eventually plunged \$80,000 in debt.

His relations with the industry that had once championed him slid from bad to dreadful. The California thrifts, formerly the core of his support, passed the word that Ed Gray was not welcome at the state's 1986 convention. "Ed," one S&L executive explained, "they don't want to hear you."

The Texans Fight Back

In Texas, the hostility toward Gray built to a fever pitch. He was seen as Gray the Unfair, Gray the Lightweight, Gray the Re-Regulator, the man who wanted to shackle the industry with a new set of draconian rules. After flying home to La Jolla for Christmas in 1986, Gray received yet another call from Jim Wright. The majority leader had a particular problem. The owner of Vernon Savings, Donald Dixon, was complaining that regulators were depriving him of the chance to find new capital to save his S&L.

Wright had met Dixon aboard his yacht, "High Spirits," but he was calling Gray at the urging of Rep. Tony Coelho (D-Calif.), who had become a regular aboard Vernon's corporate jets and on the yacht, which he used for fund-raising parties. Coelho sent Wright a memo, noting Dixon's concerns and reporting with a touch of apparent sarcasm that "a Joe Selby, with the Dallas Trouble Home Loan Bank Board, was specifically mentioned as desiring that [Vernon and Sunbelt Savings] be shut down."

In phoning Gray, Wright told the chairman that Dixon has "a week or three or four days that he can save [Vernon] and avoid foreclosure. Why don't you look into it?"

Once again, Gray was baffled by Wright. Vernon Savings, which had been under state supervision since September, was perhaps \$600 million in the red and was losing another \$10 million a month. Dixon had collected at least \$1 million in bonuses and millions more in dividends, as his institution slid ever faster toward insolvency, according to a subsequent federal lawsuit.

Vernon deserved to be shut down, Gray thought,

but that would require FSLIC to pay depositors a mind-boggling \$1.6 billion. As Gray later informed Wright's office, he could not afford to close Vernon; instead, regulators wanted a voluntary agreement placing the thrift under federal control.

What is it about these Texans? Ed Gray asked himself. Since his first meeting with the state's thrift executives back in June 1983, he had known that they were different somehow, oversized in their ambition to make money. But now they seemed to lack any sense of discipline. Much of the thrift business in Texas seemed obsessed with racking up colossal profits and letting the devil take the hindmost—all in the name of American entrepreneurship. Gray didn't buy it; the word "corrupt" came to mind frequently now.

The Texans had a different view. Durward Curlee, who lobbied in Washington on behalf of 20 Texas thrifts, thought Gray possessed a wide streak of the tyrant. "Why did Hitler go into Russia?" Curlee would demand, smiling slyly at the analogy. The chairman was five years too late and now seemed intent on strangling every thrift in the state.

The only hope for relief appeared to be through Congress, and it was Jim Wright, about to become speaker of the House, who seemed most receptive to the Texans' pleas. Wright sympathized with businessmen who stood on the verge of ruin because of the slumping economy; explaining the plight of such constituents to federal regulators, he believed, was a big part of his job.

On Jan. 6, 1987, as the 100th Congress convened, a bill to inject \$15 billion into FSLIC was introduced in the House. This "recapitalization" proposal immediately drew fire from the industry, which feared that \$15 billion in Ed Gray's hands would permit him to close thrifts willy-nilly and sell off their holdings, depressing real estate prices. The U.S. League of Savings Institutions endorsed a \$5 billion plan, with "forbearance" provisions that required regulators to ease up on "well-managed institutions in trouble due to local economic conditions."

Desperate to shore up the insurance fund, the Bank Board summoned top officials from the district banks to testify at hearings scheduled before the House Banking Committee on Jan. 21 and 22. The thrift industry's biggest guns also showed up, the regulators and the regulated often perched elbow-to-elbow in the audience. Dallas bank president Roy Green, sitting with Joe Selby, greeted a familiar figure in a nearby chair.

"Joe," Green said, "have you met Durward Curlee?"

"Oh, yeah," Curlee quipped as he shook Selby's hand, "I've heard of you through a mutual friend. From what I understand, he's the only friend you've got."

'The Speaker Hates Us'

After the morning testimony, several thrift executives, including W.W. (Bo) McAllister of San Antonio, Texas Savings and Loan League president Tom S. King and U.S. League president William O'Connell met for lunch with Wright and other members of the Texas delegation. "Speaker Wright indicated to us that he was considering 'slowing up' the FSLIC recap until he was satisfied with efforts toward forbearance," McAllister wrote in the Texas League's magazine two months later. "We encouraged him to take this action and that is exactly what happened." Wright later denied "holding hostage" any legislation, saying the bill went through "normal legislative channels" and that he later supported the full \$15 billion proposal.

In early February, the regulators decided to meet with Wright to make their case. The idea came from Selby and Green, who wanted to make peace with the speaker. Gray, though less sanguine, appreciated the session's importance, and made sure he was represented by two of his top aides. Gray thought Wright was ducking him, and he instructed his secretary to call the speaker's office every 15 minutes

for a week. If nothing else, Gray wanted to show that if the two men weren't communicating, it was not his fault.

As Selby and Green entered Wright's antechamber on Feb. 10, they were surprised to find a familiar face from Texas already there. It was George Mallick, the Fort Worth developer, Wright's friend and business partner. The regulators had brought along a sheaf of inside information to explain their actions against thrifts that had gotten Wright's attention. But there was no way they could go into details with Mallick in the room. So much for Plan A, Green thought to himself.

Wright sat behind his desk, facing a semicircle of regulators. To the sides stood George Mallick; Mallick's son, Michael, and a line of congressional assistants. Green began by outlining the general state of Texas thrifts and what the Dallas bank was doing to help them. He said regulators were trying to be lenient, but this was counterproductive in the long run. Sick thrifts could attract depositors only by offering high interest rates; healthy ones followed suit, reducing their profits and threatening their stability.

Selby spoke next. This was the first and only time in his life he would meet Jim Wright, his one chance to talk to the man who two months earlier had called him a homosexual and allegedly sought his removal.

"I just wanted to come and show you in person that we don't have horns," Selby said.

Wright let it pass, but later in the meeting he turned to Selby and said: "And you, you are the most feared man in the state of Texas. You carry the biggest hammer. Institutions tremble when they hear your name."

Much of Wright's information about Selby and the regulators in Dallas came from a report he had asked Mallick to prepare. That report reinforced Wright's perspective during the meeting.

Federal regulators in Texas, Mallick wrote, had been abusing their powers, making threats that they could close any thrift—insolvent or not. Why were they so tough on Texans, Mallick wondered, when New York bankers were being instructed to go easy on Third World debtors? Sick institutions were not offered the chance to get well, to "weather the real estate markets."

Mallick painted a picture of oppression: "A systematic thread of horror stories that involve unfair, unjust, intimidating, unduly expensive and illegal tactics has been the modus operandi of the regulatory agents in District Nine." He closed with an appeal to Wright as a champion of oppressed peoples and "people who are the single-family homeowners, the developers, the appraisers and the thrift owners themselves."

Wright took the floor. In two of the S&L matters that he had studied, Wright said, he found the regulators' behavior unsatisfactory. Particularly in the case of Vernon Savings, which one of the regulators had noted earlier, Wright said, Ed Gray had misled him by saying the institution would not be shut down.

William K. Black, one of Gray's top assistants, couldn't let that statement go unchallenged. The regulators hadn't shut down Vernon, he told Wright; its managers had signed a voluntary agreement placing it under federal control.

That, responded Wright, is a distinction without a difference. Black began to reply, and Wright lost his temper. His trademark bushy eyebrows twitched. His face reddened. "Wait just a goddamn minute!" he shouted. "I waited patiently for you and heard you represent your case. Now you listen to me! You're giving me a bunch of goddamn semantics!"

His outburst lasted 20 seconds, followed by a long silence. For all practical purposes, the meeting was over. What a disaster, thought Joe Selby.

Gray's aides, Black and William Robertson, had the same feeling. In the cab ride back to the bank board office, Robertson worked himself into a nervous frenzy. "What are we going to do now?" he asked. "The speaker hates us! Recap is shot! We'll all get fired!"

When Ed Gray heard about the meeting, he concluded that his dealings with Wright were over. No more appealing the speaker to win support for the FSLIC legislation. But that decision did not free Gray; he was too depressed to feel free. His term as chairman was about to expire. If the federal insurance fund was to be saved, he realized, it would be after his departure.

He shifted his focus from the shadows of the moment—Jim Wright, the Texans, leaders of an industry that had once loved him—to safeguarding his place in history. He had been the bank board chairman during the most calamitous period in the history of American thrifts. His name would be attached to that, one way or another.

He began collecting every speech he had ever delivered, every piece of testimony he had ever written, every article he could find on his tenure. "Everything is for history," he told Fairbanks, his chief of staff. He organized his works into a chronology and placed them inside blue bindings. The anthology eventually reached 12 volumes. He was convinced that he had done the right thing, but that no one would recognize his accomplishments until he was gone. "Joe, one day we're going to be proved right," he told Selby. "We're going to be proved exactly right."

A Bitter Victory

In the gloom of his final six months, Gray found joy for one day—Feb. 27, 1987, the day his nemesis, Donald T. Regan, was fired as White House chief of staff. Calling his staff to his office, the chairman popped open three bottles of champagne and they celebrated into the night. "I'm very proud I didn't give in to that guy," Gray said. "He wanted me to bow and scrape, and I wouldn't do it."

The next month Gray won another bitter victory of sorts. On the morning of March 20, more than 200 of his regulators entered the main office and 10 branches of Vernon Savings and Loan, seized the records, and placed the thrift into federal receivership. Vernon, the institution that provoked Jim Wright's call to Gray three months earlier, now had legal exposure on sour deals of more than \$6 billion.

A certain symmetry was at play. The regulators planned the seizure the night before at the Grand Kempinski Hotel in north Dallas. Formerly called the Registry Hotel, this was where Ed Gray had stayed in the spring of 1983 during his first visit to Texas as the new optimistic bank board chairman. It was there that S&L operator Spencer Blain, now permanently barred from the S&L business, had taken him for a spin in his blue Rolls Royce.

Gray stayed on the job three more months—he would not leave until the final minute of his final day, June 30—but there were no more battles for him to win. A compromise bill pumping \$10.8 billion into FSLIC, the issue that had consumed him for more than a year, would not be signed into law until Aug. 10. In his final days, Gray spent his time compiling his version of history. His internal turmoil seemed to manifest itself physically. His clothes became increasingly disheveled and his face became more pallid and drawn. "It was horrible," chief of staff Fairbanks later recalled. "There was no lightness to him."

On his final day, Fairbanks had to drag him away from his typewriter for a meeting in the second-floor auditorium. When they arrived, the place was packed. Some 700 members of the bank board staff had gathered for a farewell party.

As Ed Gray, his clothes rumpled, his soul tormented, walked through the throng, Kenny Rogers' "The Gambler" pounded through a set of giant stereo speakers. "You got to know when to hold 'em, know when to fold 'em, know when to walk away. And know when to run."

NEXT: Crisis becomes calamity

Staff writer Charles R. Babcock and staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.

Grappling With Aftermath of S&L Debacle

Amid Bailout Effort, What Deregulation Should Mean Is Debated

By David Maraniss and Rick Atkinson
Washington Post Staff Writers

DALLAS

So this is what you get, Joe Selby thought to himself. This is the thanks you get for doing your job as the chief supervisor here, for being the toughest regulator in the nation. You get fired. Your proteges get canned along with you. No phone calls of gratitude, no thank you letters, not one director of the Federal Home Loan Bank of Dallas expressing a hint of appreciation for the two years you devoted to purging the bad guys from the savings and loan industry in Texas.

At breakfast two days earlier, in the coffee shop of a downtown Washington hotel, Selby had faced his executioner: George Barclay, the new president of the Dallas district bank. "Joe," Barclay told him, "the process is not working the way it should. One of us is going to have to leave, and I would prefer it not be me." Forty-eight hours later, on Thursday morning, April 28, 1988, the two men were back in Dallas. One was packing. It was not Barclay.

The toughest regulator in the nation cleaned out his office. First, he packed the small figurine of a gun-toting muscleman in a space suit; mounted on a walnut base, the statue was a gift from a Texas thrift executive who had inscribed a moniker on the brass plaque: *H. Joe Rambo Selby*. Second, he put away a framed \$3 bill with the motto "In Don We Trust," a promotional gimmick immortalizing Donald Dixon, head of a savings and loan Selby had cracked down on despite intervention by then-Speaker of the House Jim Wright (D-Tex.). Third, came a gift from another savings and loan association manager with a sense of humor—the

gauntlet from a suit of armor. Finally, Selby packed the black T-shirt given him by Linwood Bowman, the good-natured Texas state regulator: *Kill 'em All and Let God Sort 'em Out*.

As he moved through his third-floor office for the last time, carefully placing the mementoes in cardboard boxes, Selby pondered his fate. When Ed Gray had chaired the regulatory system in Washington and Roy Green presided over the regional staff in Dallas, Selby felt secure. His bosses not only encouraged him, they also protected him from intense political and industry pressure. But Gray had been gone for a year, and Green for several months. Perhaps it was inevitable that Selby would not survive without them.

Who had done him in? When Barclay fired him, the Dallas bank president had accepted 30 percent of the responsibility and ascribed 70 percent to Gray's successor at the Federal Home Loan Bank Board, M. Danny Wall. Yet Selby believed a third factor had influenced the decision.

"Jim Wright got me, didn't he?" he asked Barclay repeatedly. In November 1986, Wright had asked Gray to fire Selby. The chairman refused. Now, with Gray gone, Wright had triumphed after all, Selby believed.

No, Barclay replied, it wasn't just Wright. The larger problem was that Selby seemed to demand that the staff be more loyal to him than to Barclay. Besides, his administrative talents left something to be desired. He had done an admirable job under difficult circumstances, Barclay explained, but times had changed. This was the dawn of a more optimistic era, and Harry Joe Selby had the taint of the bitter old one.

Ducking the Hard Decisions

As the spring of 1988 yielded to a brutally hot summer in Texas and Washington, no one more personified that new epoch of optimism than Melvin Danny Wall. A one-time urban renewal czar—first in Fargo, N.D., then in Salt Lake City—Wall had migrated to Washington in 1976 on the staff of newly elected Sen. Jake Garn (R-Utah).

When Garn became chairman of the Senate Banking Committee in 1981, Wall became the panel's staff director. Months before Gray's term as Bank Board chairman expired, Wall began campaigning for the job so ardently that the bank staff lampooned him in their Christmas 1986 skit, belting out "If I Were a Chairman" to the tune of "If I Were a Rich Man" from the musical "Fiddler on the Roof."

Now, after a year in office, Wall was being lampooned publicly—ridiculed might be a better description—for his buoyant proclamations that the S&L crisis was less bleak than some experts claimed. After predicting that the Texas mess could be cleaned up for \$7 billion, Wall had since been forced to double that estimate. "His optimism for the business outstripped even the industry itself," said Tom S. King, president of the Texas Savings and Loan League, which presented the balding Wall with a gigantic comb as a symbol of his eternal hopefulness. Wall's House Banking Committee Chairman Rep. Herry B. Gonzalez (D-Tex.), began referring derisively to the "Wall-Number-of-the-Month"; within the agency he headed, he became known as M. Danny Isuzu, an allusion to the chipper prevaricator in a popular television commercial.

Such gibes, Wall believed, were deeply unfair. The Bank Board was making the best of a bad situation, he felt. Estimating the damage was nearly impossible, particularly in oil patch states like Texas, where the plummeting economy acted as a dead weight on the thrift industry. To stanch the bleeding in Texas, the board devised its so-called Southwest Plan, closing or merging more than 100 insolvent thrifts and attracting new owner-investors with federal subsidies and tax breaks. Water cooler wits dubbed the plan "McDeal."

Slowly, painfully, the American public was beginning to sense the magnitude of the fiscal calamity that had befallen the nation. Yet truly grasping what had happened was difficult, given the reluctance of politicians in both parties to confront the issue other than with occasional finger-pointing obfuscation.

Even that took place late in the presidential campaign. On Sept. 29, 1988, Democratic presidential nominee Michael S. Dukakis blamed the Reagan administration for permitting the disaster to unfold. Dukakis charged that Vice President George Bush, the Republican nominee, "could have headed off" the crisis as head of an earlier task force on financial deregulation, but instead had "walked away from a ticking time bomb [and] now, four years later, Mr. Bush's inattention will cost tens of billions of dollars."

For a day or two, Republicans and Democrats traded salvos. Then the guns fell silent and the savings and loan crisis largely vanished as an issue in the '88 campaign. Both parties, recognizing their vulnerability on the subject, tacitly decided to leave the hard decisions to the next president.

On Feb. 6, 1989, less than three weeks after taking office, President Bush unveiled his 500-page bailout package. Now working its way through the House and Senate, with a compromise version likely to land on Bush's desk later this summer, the legislation would dismantle the 57-year-old Federal Home Loan Bank Board system, transplant oversight responsibility to the Treasury Department, and fold the bankrupt Federal Savings and Loan Insurance Corp. (FSLIC) into the Federal Deposit Insurance Corp. (FDIC), which safeguards bank deposits. Estimated costs for the plan range from the breathtaking to the astronomical: \$157 billion, according to the administration; \$285 billion, according to the General Accounting Office.

The dollar figures are hardly more than guesses now, and so too are the estimates on how many thrifts will be left once the dust settles. Some analysts say another 800 to 1,200 savings and loans may topple in the next few years, leaving perhaps 1,500 S&Ls of the 4,000 that existed at the beginning of the 1980s. One critical factor—and an issue of bitter debate on Capitol Hill—is how much capital thrifts should keep on hand to be con-

sidered solvent. A prime element in the S&L debacle was the adoption of rules permitting high-rollers to control a thrift's assets despite risking very little of their own money; current efforts by S&L lobbyists to whittle away the capital requirements strikes some members of Congress as an invitation to replay the disaster.

On another level, the nation's lawmakers are grappling with several fundamental issues regarding commerce and government in the United States. In retrospect, it seems incontrovertible that deregulation cannot mean no regulation, at least when the full faith and credit of the U.S. Treasury is at stake. What deregulation should mean, however, is less clear, particularly in industries where the market seems to be faster, or smarter, or at least slicker than the regulators.

The crisis has spawned a cottage industry of civil litigation and criminal prosecution. An estimated 11,000 lawsuits have been filed by regulators, stockholders, directors and virtually everyone else whose ox was gored in the thrift industry. The Home Loan Bank Board has augmented its staff of 60 lawyers with attorneys from 100 outside firms. "The only profession to come out of this smelling like 20 acres of roses is the lawyers," said Robert Mettlen, former Dallas bank chairman.

Yet recouping even a modest fraction of the lost billions is unlikely. For one thing, reconstructing a paper trail is often difficult at best; FSLIC investigators involved in a suit against Lamar Savings of Austin, which once proposed opening a branch office on the moon, have identified 350,000 potentially relevant documents.

Even when the government's claim seems solid, collecting can be problematic. Spencer Blain, the flamboyant former owner of Empire Savings and Loan, agreed to repay FSLIC \$100 million as part of a civil lawsuit in which he acknowledged no wrongdoing. But federal officials hardly expect to recoup that amount since Blain's contribution to the settlement consists largely of his share in 132 Texas oil wells. Blain is on trial in Texas, charged in an 88-count indictment with systematically looting his thrift.

Bank Board officials estimate that some 170 officers, borrowers and other individuals connected to the thrift industry have been convicted of fraud and other criminal charges in the past six years. Much of the federal prosecution effort has centered on Texas. A special Justice Department task force thundered into Dallas two years ago and has notched 27 convictions. But compared to the hundreds of thrifts nationwide where past criminal activity is at least suspected, the public's thirst for vengeance—voiced daily on television and radio talk shows—may not be quenched soon.

"These are hard cases," said William C. Hendricks, chief of the Justice Department's fraud section. "Very few of these people have prior convictions . . . They're people who have lovely wives, lovely children and terrific character witnesses."

'The Black Hole'

Nowhere is the wreckage of the American thrift industry deeper than in Texas. The decade there dawned bright with the promise of limitless growth and now sets with the state mired in a profound depression. Property values have dropped 70 percent in places; office vacancy rates in places like Austin and Houston are among the nation's highest, with landlords collecting rents that are half of what they were just two years ago. Officials considering potential nominees to the Texas Business Hall of Fame find themselves drawn to the dead or retired because of concern about picking a Lone Star businessman who will turn out to be crooked, bankrupt, or both.

In 1987 and 1988, the S&L industry in Texas lost \$16 billion; about half of the state's thrifts went out of business in those two years. Of the ten U.S. thrifts suffering the most egregious losses, five were in Texas, which Bank Board chairman Wall calls "the black hole of the FSLIC." The Dallas Home Loan Bank now estimates it will cost at least \$45 billion to resolve the mess in Texas; one pundit has suggested it would be cheaper to give the state back to Mexico.

Attempts by Texans to understand what happened have been fitful, half-hearted. The governor appointed a special task force, which delivered a detailed study on the crisis in January 1988; yet task force members had to pay for their own stenographer, as well as the cost of printing the report.

Likewise, attempts by Texans to improve the state regulatory machinery have been fitful, half-hearted. A 1987 bill that would have doubled the number of state examiners and increased their paltry salaries died in committee. "I did not realize at the time," committee chairman Charles Evans explained in a recent interview, "that the industry was going under like it was." At the time, the industry was losing \$750,000 an hour.

EPILOGUE/Four Lives

DURWARD CURLEE

"Nobody did everything right. Everybody made mistakes. Horrible mistakes," said Durward Curlee, dragging on a cigarette in the shadows of a booth at the Night Hawk restaurant in Austin. His life is proof enough of that. Only four years earlier, he was the Washington lobbyist for 20 Texas thrifts; all of them have gone out of business or merged with other S&Ls.

In his heyday, Curlee earned half a million dollars a year. Now he is broke, his business ventures defunct and his personal holdings auctioned in a recent bankruptcy sale on the courthouse steps. High Flyers Inc. Gone. Side Deals Inc. Long gone. Many of his old clients are on trial or are under investigation by the federal government. The man who once likened Ed Gray to Adolf Hitler, who called the Dallas regulators the Gestapo, still feels that his good old boys in Texas have been wronged. But there is no hatred left in his voice, not even bitterness, only a sense of loss and regret and, as always in Texas, hyperbole.



If oil prices hadn't crashed, Curlee laments, "Donald Dixon would be Donald Trump. If the oil boom hadn't gone bust, these guys they're now trying to put in jail would be secretary of the Treasury."

L. LINWOOD BOWMAN III

"It happened on my watch. I can't blame it on anyone else," said L. Linwood Bowman III, offering up each word in a slow drawl punctuated by deep sighs. For five crucial years, from 1982 to 1987, Bowman was the chief S&L regulator for the state of Texas. As he readily acknowledges, the calamity unfolded before his eyes, which in a figurative sense, sometimes seemed wide-open, sometimes half-closed.

Bowman watched a troop of his employees—close friends, business associates—leave his agency to work for the thrifts they regulated. Several now find themselves in trouble. Last month his former assistant, Pat Malone, pleaded guilty to funneling corporate money illegally to Texas politicians. Two weeks ago, Bowman's business partner and former deputy, Patrick King, was indicted on similar charges.



Since he left state service two years ago, Bowman has hovered around the edges of the S&L wreck, helping insolvent thrifts manage their bad assets. He works in the Millennium Building, originally built by a savings and loan association that later went bankrupt; now the Millennium belongs to the federal government. From his headquarters in the western hills above Austin, Bowman overlooks what may be the most overbuilt city in the nation. "We just turned out," he sighs, "to be the graveyard instead of the New Jerusalem."

H. JOE SELBY

"I feel good about myself. I have nothing to be ashamed of," said H. Joe Selby on the morning of April 19, 1989. This is a pivotal day in his life, the day the House ethics committee makes public a 279-page report on Speaker Wright. The document includes a detailed account of the congressman's telephone call to Ed Gray in which he suggested that Selby was homosexual and, as the chief federal regulator in Dallas, gave preferential treatment to "a ring of homosexual lawyers."

Accounts of that phone call had been published before, but never with Selby's name attached. Now, Selby knew, his 89-year-old father and other relatives in Ganado, Tex., would read about the episode. That's unfortunate, Selby muses, but the story has taken on a life of its own, transcending his circumstances and his privacy.

After his firing last year, Selby sought to remove himself from the savings and loan scene. He began working as a financial consultant, living in Dallas but occasionally traveling to the Caribbean and Far East on jobs. Asked to run the Texas S&L department, he turned down the offer with a terse "never again." The damage had been done; the important battles fought. The entire experience still sickens him, he said, especially what he views as the ethical laxity, the incestuousness between regulators, Congress and the industry.

"My biggest surprise was that an entire industry could be raped and pillaged like it was," he added, voice rising in indignation. "Especially in my home state. It's still inconceivable to me that could have happened."



EDWIN J. GRAY

"If I had tried to be the good guy, the good old boy, right now people would be trying to lynch me around the country," said Ed Gray.

His voice on this warm spring evening in Miami has the urgency of a man trying to convince himself as much as his listeners. Since leaving Washington two years ago, Gray has mellowed in many respects: He stopped smoking; his depression lifted; his finances improved; he found more time for his wife and daughters.

But when it comes to the S&L disaster, Ed Gray remains a man possessed, a man, as Joe Selby puts it, "on a holy mission." Voluble, fervent, tireless, he portrays himself as a man more sinned against than sinning, acknowledging past mistakes—such as living a royal lifestyle at industry expense—but brushes them aside as inconsequential in the larger catastrophe.

He devours newspaper articles about the bailout bill moving through Congress. Reading of the enduring influence of the savings and loan lobby, Gray said, takes him back to the days when he felt locked in a life and death struggle with his former friends at the U.S. League, a time when, in his words, "I made myself an ass to the industry."

"They're still doing what they did then," he observed. "They're still powerful. They're still going up there with 600 local executives, trying to make it look like righteousness is on their side. Only now everyone knows what they're doing. You read about it every day. When I was there no one knew. No one knew what I had to fight."

Gray is speeding down Biscayne Boulevard at midnight, heading toward his office at Chase Federal Bank F.S.B., the only one of the nation's 3,000 thrifts to offer him a job after he left the Bank Board. The others, he said, "hate my guts."

"You have to understand," he keeps saying, voice rising, body turning away from the steering wheel to look squarely at his listeners. "You have to understand." Again he plunges back in time, recollecting in half sentences, his mind jabbing and sparring with shadows of the past:

"I was saying to myself, I'll probably go down in flames, but somehow, some way, history will say . . . I knew I had tried, I had been warning, I had gone so many miles beyond anything expected of me . . . I took the position, what do I have to lose? So I went all the way . . . Now people in Congress are coming up to me. They say, 'Ed, you've been vindicated.'

"Thank God I did those things. Now I can look myself in the mirror."

Staff writer Kathleen Day and staff researchers Melissa Mathis and Elizabeth Hudson contributed to this report.

- ~~One year ago~~
- Wanted to tell you - future MOCs / PUBLIC SERVICE
 - CURRENT SYSTEM breeds cynicism

One year ago /
LAST APRIL - ETHICS LEGIS.

(The way ~~the PAC~~ ~~raise~~ campaigns raise money, spend money, & account

1) PACS
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SOLUTION

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2) Beck
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3) Voter Paid / Soft Money
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4) Ind. Exp.

5) Pol Parties

6) Incumbency

Frank/
Commission
REGISTRATION
MONITORING

~~del~~

THE WHITE HOUSE
WASHINGTON

Date: 6/19/89

TO: Mark Davis

FROM: ROBERT J. PORTMAN
Associate Counsel
to the President



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- Comments
- FYI

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Chapter 3
Campaign Finance

The big story in the congressional elections of 1986 and 1988 was the phenomenally high percentage of House incumbents who were reelected to office. The data on campaign finance essentially reflect the data on elections. Senate elections were reasonably competitive, and about half of all Senate challengers were able to raise significant amounts of money. House elections generally were not competitive, and most House challengers -- especially Republican challengers -- were starved for funds.

The connection between fundraising and competitiveness should be no surprise. More problematic is figuring out what causes what. Do candidates fail to raise money because they are weak, or do potentially strong candidates remain weak because they cannot raise money? The 1988 election results show many individual examples that could be used to argue either side of this issue. There was the one Republican candidate who self-financed a \$200,000 campaign in a poor section of Brooklyn, New York. When the votes were counted, that candidate had earned a total of 9 per cent of the vote. Clearly, no amount

of money could have pulled that one out. In contrast, there was the challenger from Illinois who was written off at the beginning of the campaign, spent only \$69,000, and still earned 47 per cent of the vote. Or the one from North Carolina who could not convince political action committees (PACs) to take him seriously. He could get only \$21,000 from PACs out of a total campaign chest of \$250,000. That candidate found his spending swamped by the incumbent's \$580,000, but still managed to win more than 49 per cent of the vote. So causality can run in different directions for different candidates. The problem for scholars and policy makers is to search for order in the apparent chaos.

This year's campaign finance tables dramatically point out the importance of incumbency in campaign finance. They also document the continuing structural changes in the role of interest groups and parties. These two developments are not unrelated.

The first clues to reading the 1988 numbers from a challenger's perspective are in the overall House and Senate campaign expenditure tables (3-1 and 3-4). In both tables, there appears to have been a slowing down in the rapid increases in the rate of expenditure from one election to the next. After a decade of rapid growth, the rate of increase between 1986 and 1988 was modest: about 4-5% for the average House or Senate general election candidate, which was less than the rate of increase for the Consumer Price Index over the same two year period (table 5-9).

But the average for all candidates hides some important divergences. The average Senate incumbent of 1988 spent 18 per cent more than the incumbents of 1986, and the average House incumbents spent 13 per cent more. These rates of increase were about the same for Republican and Democratic incumbents. For challengers, however, party ^{was} ~~made~~ a key variable. The average Senate Democratic challenger spent 28 per cent more in 1988 than 1986. The average House Democratic challenger stayed about even. But the picture for Republican challengers was radically different: the average 1988 House Republican challenger had to get by with 10 per cent less money than the average challenger of 1986; for Senate challengers the drop off was a remarkable 15%. Combining incumbent fundraising gains with the problems of GOP challengers, the average financial gap between Democratic incumbents and Republican challengers was 18 per cent wider for House races in 1988 than in 1986, and 24 per cent wider for Senate races.

To put this another way: a challenger in an average district could easily have to spend \$500,000 to defeat an incumbent. Of the 140 candidates who spent that much in 1988 (Table 3-3), 99 were incumbents, 24 were open seat candidates and only 17 were challengers. To become credible at all would probably take the average challenger at least \$200,000. Of the 410 candidates who spent \$200,000 or more in 1988 (Table 3-2), 302 were incumbents, 66 were challengers and 42 were open seat

candidates. In other words, 346 of 412 incumbents running in the 1988 general election (84 per cent) did not have to face a challenger who could afford to spend \$200,000 on the campaign.

As in past years, the tables show that the candidates with the severest fundraising problems were House and Senate challengers defeated by large (60% plus) margins. (Tables 3-5 through 3-8). Challengers in closer races do better, but the fact is there were relatively few close House races in 1988. Open seat candidates fared better: almost all raised at least \$200,000.

Structural shifts in campaign finance have been just as important as the increases in the overall rates of spending and may well have contributed to the disparities between incumbents and challengers. Tables 3-9 and 3-10 show that the role PACs played in Senate elections stayed about the same between 1986 and 1988 but the role of the parties increased modestly. In House elections, PACs continued to increase their proportional role, as did the Democratic Party organization, but House Republicans stayed more or less steady. As in the past, Democrats rely more on PACs than Republicans, House candidates more than Senate candidates and incumbents more than challengers.

Putting the three variables together in their most extreme combinations: House Democratic incumbents received 52 per cent of their money from PACs, compared to 11 per cent for Senate Republican challengers and 10 per cent for House Republican chal-

lengers. The reverse pattern holds for party money: Senate Republican challengers received 18 per cent of their funds from the party; House Democratic incumbents received 2 per cent.

That Republicans continue to depend more on their party organization than Democrats, should not mask the fact that the role of the Democratic party has been growing steadily since 1982. This is evident not only in the figures showing the percentage dependence on party funds (3-10), but also in the in the two basic party tables (3-11 and 3-12). The party tables show the major national Democratic party organizations beginning to close the gap on the traditional Republican party fundraising advantage.

Table 3-13 ^{is the first in} begins a series on political action committees. Of these, the most revealing for the incumbent-challenger theme are 3-18 and 3-19. The two tables show how different kinds of PACs distribute their House (3-18) and Senate (3-19) contributions among different kinds of candidates. In the first few elections under the post-1974 disclosure system, labor PAC money went overwhelmingly to Democrats, business money (corporations and associations) went to Republicans by a 3:2 ratio, and non-connected PACs were overwhelmingly Republican and conservative. This began shifting in 1982 and 1984. By 1988, two-thirds of the House money and three-fifths of the Senate money from nonconnected PACs was going to Democrats. Meanwhile, corporate PACs were giving 52 per cent of their House contribu-

tions to Democrats and associations were giving the Democrats 5 per cent. (In the Senate, corporations and associations continued to give more to Republicans than Democrats.)

The overall partisan shift of PAC money toward the Democrats has occurred because of the way three different phenomena have come together. First, organized labor has behaved almost as an ideological group or a quasi-political party. It consistently has given more than 90 per cent of its growing pool of money to Democrats, and consistently has been willing to give money to challengers and open seat candidates.

Non-connected groups also have always been willing to give to challengers and open seat candidates. This category includes most of the ideological and issue groups. The partisan shift among these groups did not happen because existing groups changed stripes, but because new groups were forming, adding new money into the pool. The new groups, between 1982 and 1988, were predominantly liberal -- whether anti-nuclear, pro-environmental, pro-choice or pro-elderly.

Business groups have not changed their political stripes: they have all but dropped them. They give to Democrats in House races, and Republicans in Senate races, not because they are either Democratic or Republican. Most business groups have simply shifted from being organizations that were willing to give significant amounts to challengers and open seat candidates -- 30 per cent in 1980 and 23 per cent in 1982) -- to ten per cent in 1988.

The net result of the three trends: all incumbents are well funded. So too are most Democratic challengers with a serious chance of winning. The average losing Democratic challenger who earned 40 per cent or more of the vote, raised \$100,000 more than a losing Republican challenger in a comparable circumstance (\$439,612 to \$333,865). That difference was caused entirely by PAC contributions. The average losing Democrat with 40 per cent or more of the vote, received \$171,475 from PACs, versus only \$47,977 for a similar Republican. It would be wrong, therefore, to say that PACs only support incumbents. Many PACs support viable Democratic challengers. Republican challengers are the ones who are left out.

Coalitions for America

Paul M. Weyrich
National Chairman
Eric Licht
President
M. Kimberly Roberts
Director
Library Court
Social Issues
Stanton
Defense & Foreign Policy
Kingston
Budget & Economic Policy
721 Group
Judicial & Legal Policy
Carroll Group
Catholic Coalition
The Omega Alliance
Young Activist Coalition
Resistance Support Alliance
Freedom Fighter Policy
Jewish/Conservative Alliance

721 Second Street
Capitol Hill
Washington, D.C. 20002
(202) 546-3003

Memorandum to: Paul Weyrich

From: Ed Ceol and Eric Licht

Date: June 19, 1989

Re: Boyden Gray's PAC Reform Proposals

We have reviewed the reports of Boyden Gray's PAC Reform Option Memo. It is an interesting set of proposals, some with merit, others, in our view, without merit. The sum total of what is being proposed would have the effect of taking independent voices out of the political process and would require that virtually all political activity be channeled through the political parties. While this probably seems attractive on the surface, especially to the party officials, a closer look at the package could well mean that, if passed as is, this will mean the end of the two party system.

The Republicans have apparently forgotten that it was a great deal of independent political activity in the 1970's and 1980 that paved the way for the election of Ronald Reagan. And, as you of all people well know, there would not have been a Republican controlled Senate if it had just been up to the Republican Party.

The real danger, considering what kind of Congress we are dealing with, is that the objectionable parts of this legislation, along with "Reforms" advocated by our enemies in the Congress will be passed, leaving out the good aspects of this package (such as codification of the Beck decision and eliminating most incumbent mass franked mail), thus leaving Bush with the option of either signing a bill which would hurt conservatives or being against "Reform." Our guess is that the President, considering the climate in which we are operating, would opt to sign a bad bill.

We might be able to back most of the package (except for the

limitation of the size of contributions of ideological PACs) if it were non-severable. However, that is unlikely.

The real question is what do we do if the effort to put independent voices out of the political process does pass in the form of Gray's recommendations. Where do we go? On the assumption that you are not inclined to fold up and go away (we know you too well for that), then we recommend calling a conference to get conservatives to explore setting up new political parties in the various states. One would hate to see a New York style Conservative or Right-to-Life party duplicated elsewhere, but if that is what it takes for our kind of politics to prosper, then we believe you must do what has to be done.

Memorandum on President Bush's Proposed PAC Reform Legislation

TO: Senator Jesse Helms

FROM: Paul M. Weyrich

It is our understanding that Boyden Gray has included the following provisions in his campaign finance reform option memo to President Bush. At this stage, as we understand it, no decisions have been made by Bush.

1. the recommendations is to effectively abolish union, corporate, and trade association PACS.

2. they would limit ideological PACs to \$1,000 per candidate, per election, or allow said PACs to contribute \$15,000 to the national parties, and \$5,000 to the state parties.

OR MAY Keep at \$5,000!

3. they would prohibit candidates from having more than one PAC, and abolish all leadership PACs.

4. they would prohibit "bundling". ?

5. they would codify the Beck decision, something with which we, ? of course agree.

6. they would permit union and corporate voter registration drives, as long as the sources of their funding were fully disclosed.

7. they would require anyone conducting an independent expenditure to give additional and timely notice to all involved or affected, the persons or groups paying for the independent expenditure would have to be identified personally and upfront in any advertising, and if there is any charge of collusion the FEC would be empowered to hold a hearing in three days.

8. they would raise the allowable party spending limits for political parties from 2 cents times the voting age population to 5 cents times the voting age population, and it would waive the individual contribution limits to political parties, so individuals could give unlimited amounts to the parties but not to candidates or PACs.

9. they would mandate that excess campaign funds be disposed of at the end of each cycle in one of three ways: by contributing all excess funds to the national parties, by giving all contributors pro-rated refund, or by using the money to help retire the national debt.

10. they would ban most mass mailings under the franking privilege

11. they advocate that the President endorse "non-partisan" criteria for redistricting

12. they would require full soft money disclosure from unions, corporations, and the national parties.

13. they would call for an outright ban on honoraria.

the net effect of all this will be to take virtually everyone else out of the political process except the parties and the ultimate effect of that will be the end of the two party system as, to be effective, outside forces will resort to forming new parties in the states.

MEMORANDUM

CAMPAIGN FINANCE REFORM MEETING

June 21, 1989

2:00 p.m.

Roosevelt Room

AGENDA ITEMS

1. Incorporation and Reconciliation of Decision Memo Comments:

- a. General comments
- b. Independent expenditure recommendation (Barr concerns)
- c. Honoraria/pay raise presentation
- d. Congressional contacts (executive order)

2. Tentative Event:

Thursday, June 29 (afternoon)
Library of Congress
Speech to interns
(same location as campaign speech on ethics)

3. Consultations/Briefings:

- a. Internal White House Briefings
(Press Office, others)
Need to organize formal briefings?

- b. Outside Groups

- (1) Senate Republicans:

Met with key campaign finance Members this morning;
Another meeting before they adjourn Friday?
With the President?
Presidential phone calls?
McConnell and/or Dole attendance at speech?
(Boyd Hollingsworth)

- (2) House Republicans:

Meeting scheduled with Members on Campaign Task Force 6 p.m. tonight.
Another meeting next week?
With the President?
Michel, Gingrich, Vander Jagt, others at speech?
(Jack Howard)

(3) Ideological (conservative) PACs:

Another session with Working Group next week?
(Dave Carney)

(4) "Wiley Republican Operatives":

Meeting to be scheduled as soon as possible as
part of "spin" development?
(Jan Baran, Ben Ginsberg)

(5) Campaign Reform Groups:

Common Cause, League of Women Voters (both have
requested meetings) Center for Responsive
Politics, others

Meeting early next week (Tuesday)?
Consultation prior to finalizing proposal or
briefing after the fact?
With the Working Group?
With the President?

(6) Business and Trade Association PACs

Consultation with same group we met with twice?
With the Working Group?
Union PACs???
(Jim Wray)

(7) Press Briefing:

Briefing the morning of the announcement (6/29)?
Need list of appropriate participants.

(Alixé Glen, Ben Ginsberg)

(8) P.R.:

T.V. talk shows?
Op Ed pieces?
(David Demarest, Alixé Glen)

(9) Hill Democrats:

Presidential courtesy calls to key campaign
finance Democrats
(e.g.: Boren, Mitchell, Foley, Swift)?
(Fred McClure)

June 15

Boyd Orr, Tom, Jim Pugh, D²,
J. Cicconi, Bobbi, Andy Cano

B. Gray: (DATE) 3RD PART
Oneleg (1) Revolving Door / Conflicts of Interest

Twoleg (2) Speech should REITERATE commitments already
then HONORARIA of POTUS ready ^{voiced}
100K

HONORARIA ← → PAY RAISE

Threeleg (3)

Campaign Finance Reform - most money
involved.

MEMO CIRCULATED

We propose
* to eliminate big + union PACS (but
not special cause PACS - like Right to
Life or Enviro.) S.I. \$ FRAG. Courts,
reduces competition between people +
ideas - won't eliminate \$ - but

Only "FREE-STANDING PACS" - no
sponsorship w/ union or business.

(Business will support, ~~the~~ lobbyists will
SCREAM)

[Lit into S+L's as a prime example
Walter Buffit - where S+L ~~lobbys~~ lobbyists
- represented only the most scurrilous
members]

90% of PAC money \$150 million annually

FOCUS: BUSINESS

~~NOTE: Must defend~~

GETTING RID OF CORP. \$ + UNION \$.

Bright Line: Eliminate Corp. / Union
But : Protect FREE Speech

Incumbency - Limiting or Eli.
Abuse of the Frank

Resistocracy

Print Rollover - Prohibit ~~granfalton~~ ~~also~~
clause on PACs for personal / ~~also~~
Now no Rollover of campaign funds

ASK IND. AGENCIES to "LOG" contacts
from ~~the~~ Conna (A.K.A. Debbie Deane).

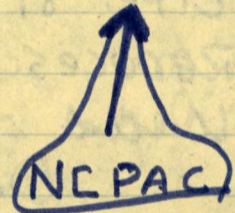


29th

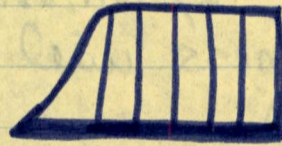
DECISION MEMO
TUES.

ALL DECISIONS DONE by Mon '26th

Speech can go on



{ PAC REFORM
BAN HONORARIA



H ← → P.R.

Talk of
Who holds money ~~on~~ ~~from candidates~~
into vote - ~~Change~~ ^{incand.}

TOM DELAY
22D DISTRICT, TEXAS
DEPUTY WHIP
COMMITTEE ON
APPROPRIATIONS
SUBCOMMITTEES
TRANSPORTATION
MILITARY CONSTRUCTION

308 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-5951

9000 SOUTHWEST FREEWAY SUITE 205
HOUSTON, TX 77074
(713) 270-4000

500 NORTH CHENANGO STREET, SUITE 312
ANGLETON, TX 77515
(409) 849-4446

Congress of the United States
House of Representatives
Washington, DC 20515

June 7, 1989

The Honorable George Bush
The White House
Washington, DC 20500

Dear Mr. President:

We are writing to you concerning the campaign reform proposal you will soon be sending to the Congress. We respectfully urge you to include in your bill a comprehensive prohibition against the use of compulsory union dues for political purposes opposed by dissenting union members.

Our current electoral system suffers from a grossly unjust imbalance in favor of union officials' political machine. Union officials and their PACs are the only political entities to enjoy federal statutes that compel workers to pay money into union treasury funds as a condition of employment.

As we are sure you noticed during your presidential campaign, this compulsory dues money finds its way into the federal electoral system through cash contributions to candidates, and through unlimited communications to union members advocating the defeat of Republican candidates.

The use of compulsory union dues to fund the administrative and overhead costs of union political action committees is worth tens of millions of dollars to Big Labor's hand-picked candidates each election cycle. However, this huge amount of money barely scratches the surface of total compulsory union dues political spending.

Union soft money expenditures on get-out-the-vote drives, unlimited mailings to union families, and assistance to state and national Democratic parties comprises the major portion of Big Labor's overwhelming spending advantage in Congressional elections.

Howard Coble

Bill Cullen

Craig T. Jones

Bob Dorman

Cass Ballenger

Nant Penguin

Lamar Smith

Chris Cox

Paul Dwyer

RJ SJ

Jim Toke

Best M. Cullen

Jane V. Hansen

Bob Walker

Dana Rohrbach

Steve BWT

June 21 - 2pm Boyden, Ginsberg, Wray, D²
et al

Eliminated frank

Reps. will ~~not~~ give Lehman reception -
Better reception in House than in Senate.

Ideological PAC's will

REDEFINE: NOT KILLING PACS - WE ARE ~~STOPPING~~
STOPPING CORP. + UNION PACS - But we will protect
F.A. Rights.

● [Bone of contention: ~~Limiting~~ Limiting
\$5,000 to \$1,000 - If we do that, we
can argue that \$1,000 (from \$5,000) is our
high ground.]

EXAMPLE: S+L's as the danger

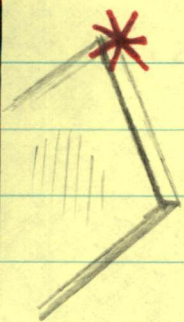
DECISION: POTUS will DECIDE \$1-5,000

Weyrich ~~has~~ threat to start third
party. [60-DAY NOTICE]
STICK TO FULLY DISCLOSED

HONORARIA - PAY RAISE / DOLE, McC. would NOT
RAISE HONORARIA IN THIS ROUND. POTUS will
DECIDE.

Ban Honoraria - The very worst - Corp +
union bucks go into pockets [INST. bribery]

Boyden



McClure: With Foley's recent pay raise -
cannot delink Hon. + p.R. issues.
Must talk of both of them in the same
breath.

D² / W/out us taking the issues / ~~the~~ Cong.
so badly humiliated
Congress will not delink judges on
its own.

McCl Must do a pay raise soon - w/ SES/
judiciary - Why not start now.

D² - not appropriate for POTUS to set
pay percentage for POTUS. ***
STRONG # on evils of honoraria.

FORMAT: I AM PROPOSING legis for hon.
AND if Congress is willing to RAISE EXEC. /
JUDICIAL AND CONGRS. LEGIS BAN HON /
BUT OFFER NO LEGIS ON PAY RAISE !
So, couple pay raise + HONORARIA in
~~the~~ rhetoric - But DECOUPLE IN ~~the~~ LEGIS.

Republicans strong (signed lie) -
to stand strong on Beck - NO SLACK
FOR LABOR

~~the~~ This is an all or nothing package -
No half measures.

Boyer pen for
FRED McCLURE
opposition

Boyd: Congressmen / queens / LOG CALLS TO AGENCIES - Demand logging for Congress.
~~Boyd~~ Agencies must log all contacts w/ MOCs - Must now include MOCs to agencies

Congress insists they know W.H. contacts w/ its own exec. branch. Why should not the legis. have this same restriction. FOAI

Rhetorical work - put them in defense
Sunshine / Too many special int. wouldn't ~~help~~ through Congress to ~~GET~~ GET TO AGENCIES
Mess in S+L / PROCUREMENT
Calls from Wright

~~DIRA~~ DIRA - Office of Inv. Reg. Affairs

McConnell - Pres. Funding system change?
McC - DO AWAY w/ limits / system / HOLD TO \$5,000.

NOT PART OF DEBATE RIGHT NOW -

LOWEST UNIT RATE / ~~WON'T~~ WON'T GET INTO TO
EXCESS - USE OF CAMPAIGN FUNDS ON OFFICE, TAKING CONST. TO WAUCH

GET RID OF GRANDFATHER / ALLOW SOME ROLLOVER

~~NO OFFICE EXPENSE~~

D² - People contribute to elect, not to buy TV/office equip.

YET spousal travel not paid for by gov - But let them raise the money themselves.

Possible cap on Rollovers.

3 ELEMENTS: 1) GRANDFATHER CLAUSE / ELIMINATE
2) ROLLOVER / EITHER ZERO
3) / OR CAP

Briefing Consultations

TIME-LINE by FRIDAY - briefing

D² - LET'S DO A "DECISIONWAC"

WASHINGTON
OCCIDENTAL
783-1475
AUBERGE
759-3900

Party Reform and the Public Interest

EVERETT CARLL LADD

The way the United States chooses its political leadership—especially the way it picks its presidents—the condition of its political parties, and the parties' place in the governing process have long been the object of critical attention. Arguments on the imperative of "reform" are being raised today much as they have been over the past century. Is the American system of parties and elections in fact failing the country? Does this system need fixing to enable it to better advance what are variously called common, public, and national interests?

SERVING THE NATIONAL INTEREST

Before exploring this question, I should note that American political science has had a terrible time grappling with the idea of the public interest. Glendon Schubert argued in a 1960 study that the concept "makes no operational sense, notwithstanding the efforts of a generation of capable scholars Political scientists might better spend their time nurturing concepts that offer greater promise of becoming useful tools in the scientific study of political responsibility."¹ Frank Sorauf nominated the term "public interest" as a leading candidate for inclusion in "a list of ambiguous words and phrases 'which never would be missed'."² Robert

¹ Glendon Schubert, *The Public Interest* (New York: Free Press, 1960), 224.

² Frank Sorauf, "The Conceptual Muddle" in Carl J. Friedrich, ed., *The Public Interest* (New York: Atherton Press, 1962), 190.

EVERETT CARLL LADD is professor of political science at the University of Connecticut and executive director and president of the Roper Center for Public Opinion Research. He is the author of numerous books and articles on American political life, including *Ideology in America*, *American Political Parties*, *Transformations of the American Party System*, 2d. ed. rev. (with Charles Hadley), and *The American Polity*, 2d. ed. rev. An earlier version of this article appeared in *Elections American Style* edited by A. James Reichley and published by the Brookings Institution.

Dahl and Charles Lindblom have insisted that in most instances the meaning of the national or public interest is "left totally undefined Often enough a precise examination would show that it can mean nothing more than whatever happens to be the speaker's own view as to a desirable public policy."³ According to Howard Reiter, radical political scientists (in whose company he places himself), "argue that in any society dominated by class interests, like the United States, there can be no general interest that unites all classes, and the concept of a 'public interest' is a sham intended to fool the lower classes into supporting the interests of the upper classes."⁴

Other scholars have found the concept of public or national interests highly meaningful, of course, and I put myself in their ranks.⁵ In discussing their political aspirations most people seem to find the concept natural and essential. Probably this is because, as Daniel Bell and Irving Kristol argued in introducing their magazine, *The Public Interest*, "there has never been a society which was not, in some way, and to some extent guided by this ideal"⁶

I content myself with a few basic distinctions. Most people seem able to distinguish between interests that are broadly shared and those that are quite narrow. Obtaining a system that provides high quality public education on its face reflects a broader constellation of interests than does a special tax write-off for Uptight Motors, Inc. Furthermore, some interests are fundamental and enduring; pursuit of immediate goals that threaten basic long-term objectives is counter to the national interest. For Americans, their national interest includes their country's security and the maintenance of an environment conducive to national hopes for the extension of liberty and democracy around the world. It includes, too, a healthy, growing economy that extends economic opportunity. And surely, most Americans see it in the national interest that successful popular governance be obtained. Does the American party and electoral system do as much as any other we can specify to serve such broad, enduring ends? Or does it sacrifice them by being too responsive to claims that are narrow, particularistic, special, short-sighted and short-term?

THE CASE THAT THE SYSTEM PROVIDES GOVERNMENT TOO INATTENTIVE TO THE NATIONAL INTEREST

Specific criticisms of the parties and the electoral system for insufficiently serving the pursuit of broad public interests cannot really be separated from more general criticisms of the entire American system of widely dispersed and decentralized

³ Robert A. Dahl and Charles E. Lindblom, *Politics, Economics and Welfare* (New York: Harper, 1963), 501.

⁴ Howard L. Reiter, *Parties and Elections in Corporate America* (New York: St. Martins Press, 1987), 63.

⁵ See, among recent writers, Virginia Held, *The Public Interest and Individual Interests* (New York: Basic Books, 1970); and Richard E. Flathman, *The Public Interest: An Essay Concerning the Normative Discourse of Politics* (New York: John Wiley, 1966).

⁶ Daniel Bell and Irving Kristol, "What is the Public Interest?" *The Public Interest* 1 (Fall 1965): 5.

governmental authority. Most century for strengthening the policy process stem from and all its ramifications — with or as an overall strength intermediary of relatively d

In *Congressional Governm* forcefully the argument that authority frustrate the achieve he wrote, "the federal govern lacks promptness because its processes are roundabout, and its actions without com the policy of the governmen twist and alter it; a dozen o Washington put it into exec

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⁷ Woodrow Wilson, *Congressional Hopkins University Press, 1981), 206*

⁸ *Ibid.*, 206.

⁹ Woodrow Wilson, *Constitutional sity Press, 1908).*

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GOVERNMENT TOO INATTENTIVE INTEREST

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Economics and Welfare (New York: Harper, *ate America* (New York: St. Martins Press,

Interest and Individual Interests (New York: *c Interest: An Essay Concerning the Norma-*

interest?" *The Public Interest* 1 (Fall 1965): 5.

governmental authority. Most arguments that have been advanced throughout this century for strengthening political parties in their control over nominations and the policy process stem from one underlying assumption: the separation of powers and all its ramifications — whether seen as a serious deficiency that must be lived with or as an overall strength that has its downside — need mitigation through the intermediary of relatively disciplined and integrated parties.

In *Congressional Government*, first published in 1885, Woodrow Wilson stated forcefully the argument that the American system and its extreme dispersion of authority frustrate the achievement of national interests. "As at present constituted," he wrote, "the federal government lacks strength because its powers are divided, lacks promptness because its authorities are multiplied, lacks wieldiness because its processes are roundabout, lacks efficiency because its responsibility is indistinct and its actions without competent direction Nobody stands sponsor for the policy of the government. A dozen men originate it; a dozen compromises twist and alter it; a dozen offices whose names are scarcely known outside of Washington put it into execution."⁷

In this view, the system hampers pursuit of the national interest first by making it virtually impossible for government to frame the kind of coherent, integrated approaches to complex policies that are required. The policy incoherence bred of separation of powers was one thing in 1793; when the federal government did very little and could take a long time doing it. It was already something quite different, Wilson thought, by the late nineteenth century when, he observed, "the sphere and influence of national administration and national legislation are widening rapidly and populations . . . growing at such a rate that one's reckoning staggers at counting"⁸ Wilson was then a strong advocate of responsible party leadership and an admirer of the British system of cabinet government. He stopped short of advocating its application in America as a remedy for the ills he observed, but throughout *Congressional Government* he lamented the weakness of the American "committee system of government" with its ineffectual parties and extolled the virtues of the British parliamentary system with its disciplined parties and responsible ministries.

Wilson's early advocacy of responsible party government was modified considerably by the turn of the century. In writing the preface of the fifteenth printing of *Congressional Government* in 1900 he argued that the nation's plunge into international politics had produced "greatly increased power and opportunity for constructive statesmanship given the President [and that as a result] the Executive . . . will have very far-reaching effect upon our whole method of government." Those views were fully developed in *Constitutional Government*, first published in 1908.⁹ Wilson did not, of course, abandon his commitment to the goal

⁷ Woodrow Wilson, *Congressional Government: A Study in American Politics* (Baltimore: Johns Hopkins University Press, 1981), 206-07.

⁸ *Ibid.*, 206.

⁹ Woodrow Wilson, *Constitutional Government in the United States* (New York: Columbia University Press, 1908).

of more coherent national leadership. Presidential leadership would replace party leadership in linking all the power centers of our constitutionally separated government.

The prevailing view in American political science since World War II has been that presidential leadership is insufficient in the absence of disciplined parties. In 1950, for example, the Committee on Political Parties of the American Political Science Association (APSA) issued its call for a system of stronger parties able to meet the national need "for more effective formulation of general policies and programs and for better integration of all of the far-flung activities of modern government."¹⁰

The American system's dispersion of authority has often been faulted for retarding political accountability and popular control. Giving the public effective means of control over a big, complex government is difficult—yet a vital national interest in any country that takes democracy seriously. A century ago, Wilson lamented that "the average citizen may be excused for esteeming government at best but a haphazard affair upon which his vote and all his influence can have but little effect. How is his choice of a representative in Congress to affect the policy of the country as regards the questions in which he is most interested . . . ? It seems almost a thing of despair to get any assurance that any vote he may cast will even in an infinitesimal degree affect the essential course of administration"¹¹

Contemporary American political science for the most part sees the strengthening of parties as essential for extending popular control over government and insuring greater responsiveness of public institutions to popular wishes. Only strong parties can so organize issues that the public can speak effectively on them. If they make elected officials in some sense collectively, rather than individually, responsible to the electorate, parties greatly expand the public's capacity to reward and punish.

Similarly, stronger and more disciplined parties have been seen as an important potential antidote—though one very difficult to come by—to extreme congressional individualism and the opening it offers the swarm of special interests. The 1950 APSA report made this case. "The value of special-interest groups in a diversified society . . . should be obvious," its authors argued. "But organized interest groups cannot do the job of the parties. Indeed, it is only when a working formula of the public interest in its general character is made manifest by the parties in terms of coherent programs that the claims of interest groups can be adjusted on the basis of political responsibility It must be obvious . . . that the whole development [the proliferation of interest groups and the extension of their sway] makes necessary a reinforced party system that can cope with the multiplied organized pressure."¹²

¹⁰ American Political Science Association, "Toward a More Responsible Two-Party System," A Report of the Committee on Political Parties, *The American Political Science Review* 44 (September 1950).

¹¹ Wilson, *Congressional Government*, 331–02.

¹² American Political Science Association, "Toward a More Responsible Two-Party System," 19.

Strong parties are needed to pick on people their interests "to pick on people their case to central party leadership conflicting demands. Strong many have their proper say in Schattschneider gave classic sized special interests has a pro wise well-positioned: "The flaysings with a strong upper-cla

AN IMPRE

If one stays within the body of one is hard put to quarrel with upon federalism and separation political authority. Indeed, in the really does not have a *government* of course, but he and his execution, not the *government*; *Constitution*, not the *government*; *Constitution* of the government for there to of the government scheme, barriers aplenty And interest groups are indeed p The system is very messy, and

The American governmental Given federalism, the parties h when individual state parties we remained fragmented. Given se evident in parliamentary system given a variety of bases from v extreme individualism that has claims for greater collective par among the public; and succeeding of further extending political in 1970s in Congress, for example they had been vis-à-vis more ce

All in all, today's parties-elect constitutionally dictated separation in a very real sense magnifies ther at all for developing comprehen torate, and seeing them through or down in the next election.

¹³ E. E. Schattschneider, *The Semi-Sovereign Democracy* (New York: Holt, Rinehart, and Winston, 1935).

Strong parties are needed to curb special-interest influence by forcing these interests "to pick on people their own size"—through requiring that they take their case to central party leadership that is charged with balancing a great variety of conflicting demands. Strong parties are also needed to help the underorganized many have their proper say in competition with the highly organized few. E. E. Schattschneider gave classic statement to the argument that the system of organized special interests has a pronounced bias in favor of the well-heeled and otherwise well-positioned: "The flaw in the pluralist heaven is that the heavenly chorus sings with a strong upper-class accent."¹³

AN IMPRESSIVE IF INCOMPLETE ANALYSIS

If one stays within the body of theory and political argument I have been reviewing, one is hard put to quarrel with it. Surely, the American governmental system, built upon federalism and separation of powers, does greatly divide and disperse political authority. Indeed, in the parliamentary sense of the term, the United States really does not have a *government* at all: The president has significant authority, of course, but he and his executive subordinates are rightly called the *administration*, not the *government*; Congress's role is so great that it would have to be part of the government for there to be a government. In our dispersed and decentralized scheme, barriers aplenty are erected to coherent, centrally-developed policies. And interest groups are indeed presented with multiple points of access at all levels. The system is very messy, and presidents invariably find it frustrating.

The American governmental order has dictated a special type of party system. Given federalism, the parties historically were organized on state lines, and even when individual state parties were robust and disciplined, the national party system remained fragmented. Given separation of powers, the case for party discipline evident in parliamentary systems could never be made, and party factions were given a variety of bases from which to maintain their independence. Given the extreme individualism that has always distinguished American political culture, claims for greater collective party authority have rarely struck a responsive chord among the public; and succeeding waves of "reform" have had the principal result of further extending political individualism. The reforms of the 1960s and early 1970s in Congress, for example, left individual members more advantaged than they had been vis-à-vis more central elements of House and Senate leadership.

All in all, today's parties-elections system does not reduce the effects of the constitutionally dictated separation of powers: rather it reflects them, and in so doing, in a very real sense magnifies them. American political parties are not well equipped at all for developing comprehensive policy positions, presenting them to the electorate, and seeing them through into legislated programs that might be voted up or down in the next election.

¹³ E. E. Schattschneider, *The Semi-Sovereign People: A Realist's View of Democracy in America* (New York: Holt, Rinehart, and Winston, 1960), 35.

THE CASE THAT THE PROPOSED CHANGES WOULD NOT IN FACT ADVANCE THE
PUBLIC INTEREST

No one who pays close attention to politics would reject out of hand every call for change in our parties and elections system. I do maintain, however, that the more substantial changes that have been proposed fail to show real promise of making things better by such national-interest standards as more responsive democratic government and wiser long-term policies. I should acknowledge that my current judgment in this regard differs to some extent from that of times past. I have always been skeptical about claims that changes proposed for one area or another of the parties and elections system should be readily recognized as reforms. Often the changes have not in fact made things better, and within a few years of their enactment the cry has been raised loudly that the reforms must themselves be reformed. The literature on past reforms is filled with references to unforeseen and unintended consequences. Nonetheless, I did at one time accept much of the argument that stronger parties would likely advance the public interest. At one time, too, I could not resist the enthusiasm that afflicted so many others for seeking ways to improve the presidential nomination process. I offered my own elegant blueprint for change, which included a bigger role for party and elected officials, in conjunction with a single, nationwide presidential primary.¹⁴ While I remain comfortable with much of the earlier analysis, I think I yielded too readily to the underlying notion that successful institutional tinkering is easily conceived.

TINKERING

Proposed changes occupy different levels of reach or comprehensiveness. Some are potentially far-reaching, such as arguments for strengthening the national parties. Others are much more limited, such as proposals for altering the schedule of presidential primaries. My concern with the latter sort of proposals is in part the familiar one about unintended consequences—that they in fact often result in two steps forward and two steps backward, or sometimes two-and-a-half steps back. They advocate change that has merit but also disadvantages.

The continuing discussion of the scheduling of presidential primaries is a good case in point. Concern has been voiced about the implications of small states (Iowa and New Hampshire) leading the parade of caucuses and primaries and permitting their Republican and Democratic electorates, which are far from national microcosms, to receive undue weight. Intense press coverage of these early contests is followed by the obligatory *Time* and *Newsweek* cover photos of “the big winners.” Infinite effort goes into establishing the “expected” showing for each candidate, which is then set against actual achievement to determine the “real” victor. In 1968 Lyndon Johnson got a majority of the Democratic vote in the New Hampshire primary, but Eugene McCarthy was seen doing better than expected

¹⁴ Everett Ladd, “A Better Way to Pick Our Presidents,” *Fortune*, 5 May 1980, 132–142.

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and this “spin” came to be imposed on the entire campaign. It is hard not to find annoying the hype that surrounds the early contests. For 1988 southern states have taken things in their own hands by scheduling an early regional primary on March 8. This balloting follows the Iowa caucuses and the New Hampshire primary, which are held in February; but its huge jackpot of delegates means that it, too, will attract an enormous amount of early press coverage. The southern electorate is already being dissected by elaborate public opinion surveys.

Are there unfortunate implications in giving one state or region, whose social and political outlook differs from the other sections, so much weight in establishing early momentum? All manner of suggestions have been made to cope with such scheduling problems. For example, some have argued for a series of four primary dates, with all states holding primaries assigned to one or another so that no region dominates any date. This has some merit. New Hampshire and Iowa would get less attention, and a more “representative” collection of states would lead things off. But there are drawbacks: candidates would be forced to campaign simultaneously in four scattered sections of the country, putting enormous burdens on them, especially on those who start with less funding and organizational resources. By leading off, manageable little Iowa and New Hampshire enable less well-known and well-heeled candidates to gain attention through presenting their wares to real people in real election settings. If a candidate with modest resources and previously lacking a national reputation manages to impress a fair number of voters in these small states, isn't this laboratory experience of some considerable interest to the country?

In offering in 1980 “a better way to pick our presidents,” I argued that we would improve things if we managed to combine in the selection system large doses of two differing, even conflicting, elements: peer review by party leaders and a strong voice for rank-and-file voters. The former would be achieved by providing that one-third of all national convention delegates be chosen wholly outside the primaries, in their capacities as party officials and officeholders. The remaining two-thirds would be chosen in state delegate-selection primaries held in every state on a single day — for example, the third Tuesday in June. Each state's delegates would be divided among the candidates in proportion to the candidates' respective shares of the state's total vote, with perhaps a threshold of 10 percent of the vote required before one gets any delegates.

Under this system a candidate who ran strongly in the national primary would almost surely add enough support from party leaders to be nominated on the first ballot. If he received 60 percent of the primary vote, for example, across the fifty states, he would go to the convention assured of roughly 40 percent of the first-round convention ballots — that is, 60 percent of the two-thirds of the delegates chosen through the primary. It would be surprising if the candidate couldn't pick up another 10 percent from the party officials. Otherwise, the convention would go on to further balloting, with no delegate bound but all aware of voter preferences. Bargaining and negotiation would finally produce the nominee.

These arguments still seem sound to me in 1987. I am less inclined to argue

confidently on behalf of their implementation today, however, than I was in 1980—for two different sorts of reasons. First, I am now more skeptical about the desirability of imposing upon the states and parties any national reform of presidential nominee selection, even assuming the political readiness in Congress to legislate such change. Respect for the federal character of presidential selection and for the private associational nature of the national parties require that Congress should not presume to tell the states and the parties that delegate-selection primaries must be held on a given date and delegates chosen according to one particular, nationally-set standard. It is entirely appropriate, of course, to try to educate and persuade the parties to consider certain approaches, like those that build a greater measure of peer review into the selection process. And here, it should be noted, recent developments give us reason to be modestly satisfied. I refer, in particular, to the Democrats' decisions to increase the numbers of party leaders and officeholders selected ex officio as convention delegates. Such gradual change, based on the lessons of experience, is wholly consistent with the modest Burkean approach to reform to which I think we should commit ourselves.

My second reason for quarreling with the position I took around 1980 is related but still distinct. We should be careful lest our laudable enthusiasm for making things better lead us to urge the parties to constantly tinker with their procedures. This argument is something more than insisting we need to be sensitive to "the unintended consequences of purposive social action." It is also more than insisting upon the need to recognize that every system of presidential selection must have its own weaknesses and biases. It involves, especially, the judgment that there is a vital national interest in achieving order, stability, and predictability in election machinery. Electoral reform should be approached from a perspective that recognizes how important it is in this area to settle on something and stick with it.

I have made this same argument with regard to the endless stream of proposals for improving campaign finance. Like Michael Malbin, I have concluded that our present arrangements for funding elections don't work badly and certainly aren't guilty, as is so often charged, of giving certain special interests a corrupting financial influence.¹⁵ Some of the changes made in the 1970s through the Federal Elections Campaign Act (FECA) and its amendments do seem to have improved things, as in providing for a far more complete accounting to the public of who receives how much in campaign contributions from whom; and undoubtedly some further improvements can be made. The greatest improvement we can now make would come from securing bipartisan agreement on an election finance scheme which, while not perfect, would meet a few basic objectives, thereby bringing to an end the long period of partisan skirmishing.

If the United States does not resist the urge to tinker with campaign finance

¹⁵ See, for example, Michael Malbin, "Looking Back at the Future of Campaign Finance Reform: Interest Groups and American Elections" in Malbin, ed., *Money and Politics in the United States* (Chatham, N.J.: Chatham House, 1984), 232-276; and Everett Ladd, "Campaign Spending And Democracy," *Ladd Report #4* (New York: Norton, 1986).

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every few years, this area may become for us what election laws for France were during the 1946-1958 Fourth Republic—subject to regular change guided by nothing more substantial than immediate partisan advantage. (Electoral law skirmishing resumed in France in the mid-1980s, when the Socialists put through changes designed to reduce expected losses.) Before every election during the Fourth Republic, a key battle was fought on what election law would prevail in the balloting: several variants of proportional representation were used, for example, each differing substantially in its implications for how votes would get translated into seats in the French National Assembly. If this comes to pass in American campaign finance law, popular confidence is bound to suffer. People in a democracy need to have confidence that the basic rules governing the way they choose their leaders have a durability that reflects an underlying propriety and legitimacy. Constant change suggests that rulemaking is a shallow, cynical, political game.

Changes sometimes have to be made, and interested parties and groups will inevitably differ as to where their interests lie. But stability in electoral rules and procedures is in the national interest. The proper goal of reform is to remove *electoral machinery* as far as possible from partisan debate and endless tinkering. The U.S. single-member district, simple majority system seems to me to offer the model. It certainly has its biases, but both parties have learned to live with it; and the American electorate has come to see it as involving generally fair, justifiably permanent rules of the game.

MAJOR SURGERY: IS MORE CENTRALLY INTEGRATED POLICY MAKING IN THE NATIONAL INTEREST?

The American system in its entirety— which includes the separation of powers and the decentralized, undisciplined party system established within it—undoubtedly makes more difficult enactment of programs that reflect some centrally inspired coherence. Even when a president wins a handsome public endorsement, he must immediately grapple with a fiercely independent Congress in which members of his own party as well as the opposition oppose him at critical junctures. Compared to parliamentary systems with relatively disciplined parties, our presidential/congressional system with undisciplined parties is surely disjointed and at times even incoherent.

Given the record of party factions that in other systems have gained working control of the government and managed to enact their programs with less compromise and adjustment than is typically required in the United States, we must question whether the biases of the American system should be seen as disadvantageous. Historian Arthur Schlesinger, Jr. argues that the key problem evident in the making of public policy in the United States isn’t that we have at hand a set of elegant programs that we can’t enact because of the fracturings attendant our system of dispersed authority. “Our problem—let’s face it—is that we don’t know what to do If we don’t know what ought to be done, efficient enactment of poor programs is a dubious accomplishment—as the experience of 1981 demon-

strates. [Schlesinger was critical of various economic proposals that the Reagan administration advanced, including the Economic Recovery Tax Act, and that Congress did in fact enact.] What is the great advantage of acting with decision and dispatch when you don't know what you are doing?"¹⁶

Schlesinger points out that as early as a century ago foreign visitors to the United States were leveling much the same criticisms of the American system of separation of powers, party indiscipline, and the absence of party accountability as we encounter today. In *The American Commonwealth*, Lord Bryce summarized the British view that these elements of the American system made it virtually impossible for it to settle major national questions. "An Englishman is disposed to ascribe these failures to the fact that as there are no leaders, there is no one responsible for the neglect of business, the miscarriage of bills, the unwise appropriation of public funds. 'In England,' he says, 'the ministry of the day bears the blame of whatever goes wrong in the House of Commons. Having a majority, it ought to be able to do what it desires.'"¹⁷

Bryce also reported the response that he encountered among American political leaders. They insisted that Congress had not settled a number of major national questions not because of defects in institutional structure "but because the division of opinion in the country regarding them has been faithfully reflected in Congress. The majority has not been strong enough to get its way; and this has happened, not only because abundant opportunities for resistance arise from the method of doing business, but still more because no distinct impulse or mandate toward any particular settlement of these questions has been received from the country. It is not for Congress to go faster than the people. When the country knows and speaks its mind, Congress will not fail to act." Schlesinger endorses this general argument. "*When the country is not sure what ought to be done, it may be that delay, debate and further consideration are not a bad idea. And if our leadership is sure what to do, it must in our democracy educate the rest—and that is not a bad idea either.*"¹⁸

Admittedly, the argument that the national interest is well served by programmatic approaches that involve delay, debate, and compromise when the country is divided and uncertain as to what should be done, has a large subjective component. This argument is distrustful of the notion that an ascendent political faction is likely to be the repository of special wisdom and insight on what programs will best advance certain ends. Schlesinger seems to have come to this perspective with some encouragement from Reagan administration policies of 1981 and 1982—policies with which he strongly disagreed. I find a recurring experience: the record of a great many ascendant factions in many different governmental contexts has demonstrated that the probability of error is so great that barriers to any faction's

being able to gain clear control is generally conducive to sound

When reasonably broad agreement on a system seems perfectly conceivable on complex policy questions. I had been told repeatedly prior to the question where the special interest-alistic Congress is wholly incapable of complexity, and hence invisible solutions. Yet no such thing happens intellectually among economists on the wisdom of a general code and coherently established. What matter.

Any governmental or electoral system by standards of enduring national Our judgments as to the adequacy by our views on their recent system advanced by some American ring and Don K. Price, at the end ring and Price "thought that British bad policy results during the leadership appeared to have been Herring's observations are v own system needs more party argued, "it is the whole tendency nation in accordance with the [T]he isolation of classes of extreme points of view that promise. The results of the British mament because of a fear of corruption does not provide a place in One party machine rules while mistakes that will oust those in suited to advancing the national system with its weak parties chief executive is forced to seek party following. His measures

¹⁶ Arthur Schlesinger, Jr., "Leave the Constitution Alone" in Donald L. Robinson, ed., *Reforming American Government* (Boulder, Colo.: Westview Press, 1985), 53.

¹⁷ James Bryce, *The American Commonwealth* (New York: Macmillan, 1918) vol. 1, 153–54.

¹⁸ Schlesinger, "Leave the Constitution Alone," p. 54. (Emphasis added.)

¹⁹ Leon D. Epstein, "What Happened" *Review* 74 (March 1980): 10; Don K. Price, *Administration Review* 3 (Autumn 1943): 3; New York: Farrar and Rinehart, 1940), esp. 20 Herring, *Presidential Leadership*,

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being able to gain clear control of the government and see its ideas through are generally conducive to sound long-term policy in the national interest.

When reasonably broad agreement is reached on a course of action, the American system seems perfectly capable of coherent and expeditious responses, even on complex policy questions. The Tax Reform Act of 1986 is a case in point. We had been told repeatedly prior to its enactment that it presented precisely the kind of question where the special interests inevitably dominate—that our hyperindividualistic Congress is wholly incapable of fending off special interest pleas given the complexity, and hence invisibility to the general public, of detailed tax code provisions. Yet no such thing happened. When substantial agreement was reached (intellectually among economists and politically among Democrats and Republicans) on the wisdom of a general course of change in tax policy, that change was swiftly and coherently established. Whether we will live to regret it is, of course, another matter.

Any governmental or electoral system can at times yield policy that passes muster by standards of enduring national interests; and similarly any can fail to do so. Our judgments as to the adequacy of a particular system are inevitably colored by our views on their recent yield. A case in point is the criticism of the British system advanced by some American political scientists, notably Pendleton Herring and Don K. Price, at the end of the 1930s. Leon Epstein notes that both Herring and Price "thought that Britain's disciplined party leadership had produced bad policy results during the 1930s, at the very time that American presidential leadership appeared to have been relatively successful."¹⁹

Herring's observations are worth considering as we contemplate whether our own system needs more party discipline and centralization. In Britain, Herring argued, "it is the whole tendency of the system that distinctive parties govern the nation in accordance with the class basis upon which their strength is organized . . . [T]he isolation of classes into separate parties prevents that modification of extreme points of view that is possible when different elements join in compromise. The results of the British Conservative Party in encouraging German armament because of a fear of communism are now apparent. Parliamentary government does not provide a place in policy formulation for all of the parties at interest. One party machine rules while the opposition elements stand aside and hope for mistakes that will oust those in power."²⁰ Such a system, Herring argued, is poorly suited to advancing the national interest. Herring found the American presidential system with its weak parties and dispersed power rather more attractive. "The chief executive is forced to seek middle ground. He cannot depend on his own party following. His measures are often supported by minority party members.

¹⁹ Leon D. Epstein, "What Happened to the British Party Model?" *The American Political Science Review* 74 (March 1980): 10; Don K. Price, "The Parliamentary and Presidential System," *Public Administration Review* 3 (Autumn 1943): 317–34; and Pendleton Herring, *Presidential Leadership* (New York: Farrar and Rinehart, 1940), esp. 128–146.

²⁰ Herring, *Presidential Leadership*, 129–30.

The separation of executive and legislative branches gives both Congress and the president an opportunity to appeal to the voters."

Epstein suggests that American political science has suffered from its infatuation through much of this century with its idealized picture of a British "responsible-party" system.²¹ Shaken from their attraction to some degree by developments in the 1930s and again by recent British experience in formulating public policy, political scientists still have not sufficiently examined questions of the institutional capacity of the British system for encouraging sound, broad-based policies. My own limited examination suggests that every party system in the advanced industrial democracies — Britain and the U.S. included — is a complex mix that reflects both the strengths and the weaknesses of the larger political-institutional system of which it is a part. Cross-national borrowing is a dubious venture.

MAJOR SURGERY: DOES THE U.S. SYSTEM NOTABLY ADVANTAGE SPECIAL INTERESTS?

The United States has a plethora of interest groups intruding into the governmental process at all levels. Moreover, the number of groups operating at the national level has burgeoned over the last quarter-century. From these developments it has been easy to reach the conclusion that the American system of dispersed governmental power, organizationally weak parties, and a hyperindividualistic legislature has given special interests a unique and excessive opportunity to shape policy. Jack L. Walker, a leading student of American interest groups, challenges the view, however, that the explosion of interest-group activity has anything at all to do with the characteristics of the American parties and elections system. The factors he cites for the expansion of group activity nationally are: long-term increases in the level of education of the population, which provides a large pool of skills on which various citizen movements can draw; development of methods of communication that are relatively inexpensive yet sophisticated; a period of social protest beginning with the civil rights demonstrations of the early 1960s, which called many established practices into question and provided a strong stimulus for change; the creation of massive new governmental programs; the subsequent response by governmental agencies and foundations of encouraging links among the service providers and consumers of the new programs; and the defensive response by groups that felt threatened by new regulatory legislation in areas like consumer protection, occupational health and safety, and environmentalism.²²

A great number of developments outside the parties and elections system have encouraged groups to organize, set up Washington offices, and try to bend programs and policies more to their wishes. It might still be, of course, that the American electoral system gives unusual opportunities to special interests; but upon

²¹ Epstein, "What Happened to the British Party Model?"

²² Jack L. Walker, "The Origins and Maintenance of Interest Groups in America," *The American Political Science Review* 77 (June 1983): 397.

examination this claim, too, democracies indicates that different forms of interest-group centralized systems fare better

In France, notes Frank L. their parties' decisions, interest from the individual members took place. Rather, they redirected agencies directly."²³ Over half that their groups rarely or not described contacts with ministers means of action; parliamentary group interventions in France are not less influential.

In Britain, decision making parties. As a result, parliamentary United States, though far from strong bonds with tightly disciplined environment, the influence of ment policy may dwarf that of No interest group or collective Republican parties comparable party in Britain. The British system to more general interests because decision makers.

Elected officials of both parties a great variety of different interests consider it in their interest to and in the various sectors where power that is the hallmark of that groups rarely dominate a may exercise great influence in tionships (involving agency buy organized interest groups) appear

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²³ Frank L. Wilson, "French Interest," *Political Science Review* 77 (December)

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examination this claim, too, appears unsubstantiated. The experience of western democracies indicates that different electoral and governmental systems stimulate different forms of interest-group intervention; it does not establish that more centralized systems fare better in resisting special interests.

In France, notes Frank L. Wilson, "with deputies voting *en bloc* according to their parties' decisions, interest groups might be expected to redirect their pressure from the individual members to the party, but there is no evidence that this shift took place. Rather, they redirected their activities toward influencing governmental agencies directly."²³ Over half of the interest-group leaders Wilson interviewed said that their groups rarely or never contacted the parties as such. These officials described contacts with ministers and civil servants as by far their most effective means of action; parliamentary lobbying ranked at the bottom of the list. Interest-group interventions in France look different from those in the United States, but are not less influential.

In Britain, decision making is highly centralized in the government and in the parties. As a result, parliamentary lobbying is relatively limited compared to the United States, though far from nonexistent. When, however, interest groups form strong bonds with tightly disciplined parties in this centralized decision-making environment, the influence of these special interests over the totality of government policy may dwarf that achieved by their counterparts in the United States. No interest group or collection of groups has influence over the Democratic or Republican parties comparable to what the labor movement has over the Labour party in Britain. The British system may have an especially difficult time responding to more general interests because of the strength of group ties to established party decision makers.

Elected officials of both parties in the United States routinely do business with a great variety of different interest groups. The reverse is also true: most groups consider it in their interest to maintain access to people on both sides of the aisle and in the various sectors where decisions are made, reflecting the dispersion of power that is the hallmark of the American system. The main result seems to be that groups rarely dominate any broad sector of national policy, although they may exercise great influence in narrower policy sectors where "iron triangle" relationships (involving agency bureau chiefs, congressional subcommittees, and well-organized interest groups) apply.

MAJOR SURGERY: DOES THE SYSTEM DIMINISH PUBLIC CONTROL?

Calls for "reform" aimed at more disciplined and "responsible" parties have typically assumed that the public is frustrated by the wide dispersion of power in which no faction is able to gain clear control of the government and see its programs comprehensively enacted. The exact opposite seems to be the case, however. When

²³ Frank L. Wilson, "French Interest Group Politics: Pluralist or Neo-Corporatist?" *The American Political Science Review* 77 (December 1983): 905.

public opinion polls ask Americans what they think about a system in which Republicans control the presidency and the Democrats, Congress, they invariably indicate their satisfaction. In the last half-century, the United States has had much experience with divided control over the presidency and Congress; and repeatedly, surveys show approval of split control rather than frustration with it.

Examining public opinion on many of the large contemporary issues, one gets a better sense of why divided control may not appear to Americans as either confusing or threatening. Again and again one finds a public that is highly ambivalent — torn between the contending partisan positions. For example, *Public Opinion* magazine has reviewed the opinions of Americans on various “role of government” questions. Over the last two decades the public has been continuously pulled in two directions. On the one hand, Americans make expansive claims for services of all sorts — many of which they expect government to provide. On the other hand, they see government as intrusive, clumsy, and problem-causing. Those who have wanted to cut back on domestic government have naturally chosen to emphasize the public’s dissatisfaction with government’s size and scope; those who want more government intervention stress the public’s appetite for services. The fact is, though, that both dimensions have been prominent in American thinking over the last two decades; the tensions between the two viewpoints, not their resolution left or right, Democratic or Republican, is the story.

Given these ambivalent feelings, fractured party control may be seen as a highly effective vehicle of popular control. If the public hasn’t made up its mind what direction it wants to go, or more precisely, has decided it doesn’t want to go consistently in any direction, what better vehicle than a system in which a loosely disciplined Democratic majority pushes one way through the Congress and a loosely disciplined Republican coalition often pushes the other way through the executive?²⁴ The policy control of an ambivalent public is enhanced by a system of dispersed authority. Frustration seems to reside more with certain party elites than with the general public.

CONCLUSIONS

The relationship of a party system to the promotion of broad national interests will never be demonstrated with the final precision of the Pythagorean theorem. It involves too many slippery concepts and too many sources of variation in end result. Nonetheless, it is striking that over the past century, in which the American system of dispersed authority has been so much lamented, so little real evidence has been accumulated supporting the argument that party discipline and centralization in policy making actually serve the national interest. Special interests don’t appear less influential in parliamentary systems with disciplined parties. Central-

²⁴ For data on the public’s conflicting views of government, see *Public Opinion*, March/April 1987, 21–33.

ized systems of policy making show sounder results. The American public system in which no party faction can be a basic case for extensive reform of the established.

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ized systems of policy making show no signs of being able to regularly produce
sounder results. The American public shows satisfaction, not frustration, with the
system in which no party faction can dominate the course of public policy. The
basic case for extensive reform of the American party system simply has not been
established.

9TH STORY of Level 1 printed in FULL format.

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Los Angeles Times

May 14, 1989, Sunday, Home Edition

SECTION: Opinion; Part 5; Page 3; Column 5; Opinion Desk

LENGTH: 1265 words

HEADLINE: CAMPAIGN CASH NOW SLUICING TO STATE PARTIES

BYLINE: By Xandra Kayden, Xandra Kayden, a research fellow at the Institute of Politics of Harvard University, is the author of *Surviving Power*, to be published this fall by Free Press.

DATELINE: CAMBRIDGE, MASS.

BODY:

The 1988 presidential election was distinguished by name calling, misrepresentation and a new low in personal vilification. But that's not all the bad news. The worst is that the system of electoral finance reform, which took from 1971 to 1979 to work out, has effectively been overthrown. This is not to say that anyone acted illegally. If anything, we might point to the success of the 1970s by noting that it took political money men another decade -- 1979 through 1988 -- to figure out ways to get around the law.

Federal campaign finance laws were intended to ensure open and fair elections. They focused on money because we have come to equate it with communication, and because it is the easiest thing to measure. The backbone of the federal law is built on limitations and disclosure. Individuals can contribute up to \$1,000, organizations \$5,000, to candidates in congressional and presidential primaries. Individuals can also give up to \$20,000 to the parties, but not more than an aggregate maximum of \$25,000 a year to candidates and parties. The security of the law lies in its disclosure provisions -- who gave what to whom -- and how the money was spent. The laws were aimed at eliminating fat-cat contributors and undue influence of big business.

In 1988 the fat cats came back in force, which is about all we know, except that more money probably went to state parties than elsewhere. We don't know specifically how much they gave, where it went nor how it was spent, because the information is too diffuse. We know that reports to the Federal Election Commission indicate a greater than 50% increase in state and local party spending that was coordinated with presidential campaigns between the last two elections; between 1984 and 1988, California state parties reported an increase in contributions from \$5 million to \$10 million for Republicans, from \$2 million to \$8 million for Democrats. Both parties' national committees -- after a bit of pressure from such groups as Common Cause -- published lists of donors who contributed \$100,000 or more.

One of the most controversial loopholes in the law is its allowance of independent spending -- defined as money spent by an individual or a group in advocating the election or defeat of a candidate, without contact between the spender and the candidate or his election committee. More than \$9 million was so spent in the 1980 election; in 1984 that had more than doubled to \$20 million. Most of it was spent by New Right groups, such as the National Conservative

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Political Action Committee and the Fund for a Conservative Majority.

Although the impact of independent spending on the election was never clear, the groups themselves were controversial because they could not be held accountable for their behavior or the nature of their message. Campaign managers considered them wild cards, even when they supported their candidate. Most campaigns and both parties tried to direct funds away from such spending into the mainstream.

Although independent spending was down in 1988, the principal reasons are probably the nature of the campaign and the decline of big spending groups because of death and squabbling among their leaders. The largest spender in this election was a new group, the National Security Political Action Committee, which produced the controversial Willie Horton ad used against Michael S. Dukakis; the committee accounted for more than \$10 million of the \$17 million in 1988 independent spending.

Because presidential campaigns are publicly funded during general elections, with private contributions prohibited, the parties are the last mainstream vehicle for donors.

State parties were "discovered" in the 1980 election when the Republican National Committee targeted 12 critical states and coordinated \$9 million in contributions from big givers, telling them how much to give and where to give it. A donation from California to the Florida state party would be reported in Tallahassee, but no one in California or Washington outside the campaign would know about it. The Democrats made a similar but smaller effort, and both parties have been developing such programs ever since.

The good news is that the money is going to the parties where it has the potential for doing far more for party-building than any reform since the Progressive era. That fact makes Edmund G. (Jerry) Brown Jr.'s decision to take over the California Democratic Party an astute move; if the state parties are the last remaining conduit for big contributors beyond presidential election years, the state parties will be the place to be in the 1990s. With better resources to recruit candidates and run campaigns, the parties would not be as dependent on self-selected candidates, and be more likely to promote those best able and qualified to win office and govern.

When we wonder why we fail to attract the best men and women to public office, we cannot ignore the terrible burdens we put upon them -- not the least of which is the ordeal of raising money (a Senate campaign, for instance, now takes an average of \$4 million). If the parties can supply most of what it takes to win, without requiring candidates to mortgage homes and empty bank accounts, we would all be better served.

Popular prejudice notwithstanding, political parties serve a critical function in American democracy. They are principally in the business of winning elections, and they cannot win if they put up candidates who fail to represent the interests of the majority of voters because they are too ideological or too corrupt. Increased funding is both to their benefit and ours.

On the negative side, the most important consequence of this boom for the state parties is that it comes at the expense of a belief that campaign reform laws eliminated fat-cat contributors.

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While it is no surprise that the GOP is indebted to the business community, the Democrats are just as dependent on large donors -- and have been, since the days of John F. Kennedy. They have made substantial strides in the past 10 years, developing a small-contributor base through direct-mail solicitations. While Democrats trail Republicans by 2-1 in fund-raising, the gap narrows every year.

There will be some discussion in Congress this term about the growing proportion of money given by political action committees (PACs) in congressional elections -- an issue long-overdue for attention. But the perception of abuse because of fat-cat contributors may be a greater threat to campaign law integrity. This goes to the very heart of reform intention. Whether "soft" money (from individuals and corporations, giving at the national level for state parties) subverts the process, or whether there is only such an appearance, the need for reform seems clear.

The best proposals would not eliminate the money but would make clear the source and amount, so that anyone interested in the flow of influence could tell who did, in fact, give what to whom. All the soft money that goes to the national parties can easily be reported to the Federal Election Commission; so should be all large in-state (more than \$1,000) and all out-of-state contributions to the state parties.

Much soft money is already reported one way or another. What is missing is a central reporting location for state parties and any reports at all from congressional campaign committees. It may just be a problem in perception, as the attorneys for the parties contend, but it is a perception related to basic beliefs about what elections are and should be in a democracy.

TYPE: Opinion

5TH STORY of Level 1 printed in FULL format.

Copyright (c) 1989 The Bureau of National Affairs, Inc.;
Daily Report for Executives

June 15, 1989, Thursday

SECTION: REGULATION, ECONOMICS AND LAW; DER No. 114

LENGTH: 686 words

HEADLINE: Federal Elections, CONSTITUTIONAL AMENDMENT LIMITING OVERALL CAMPAIGN SPENDING SEEN LIKELY

BODY:

Sens. Ernest Hollings (D-SC) and Arlen Specter (R-Pa) June 14 said that they believe they have the votes needed to pass a constitutional amendment resolution to allow Congress and the states to limit overall campaign spending.

Testifying before the Senate Rules Committee, Hollings said that the measure (SJRes 48) has enough support to garner the two-thirds majority necessary. 'In addition, I'm certain that if we put it to the states they would ratify it,' he said.

The measure will first have go to the Senate Judiciary Committee. Specter, who is ranking member of the Constitution Subcommittee, said he expects a hearing to be scheduled soon.

SJRes 48 does not propose specific spending caps, but rather gives Congress and states the power to set 'reasonable limits' on all campaign-related spending. Both senators agreed that actually setting such limits will be an arduous, long, and politically heated process. However, it will be worth the effort, Hollings said. 'I don't know where it's going to stop unless we get control of ourselves,' he commented.

Spending limits will also be the only way for Congress to win back the goodwill of the American public, Specter added. Pointing to the growing public outcry over honoraria, ethics, and congressional pay, he noted, 'We are under attack on Capitol Hill.'

A constitutional amendment is required to overturn a 1976 Supreme Court ruling, Buckley v. Valeo, in which the court struck down campaign spending limits enacted by Congress in 1974, arguing that such limits violate free speech. That was a 'bad, bad decision,' according to Hollings, who said that in effect the ruling equates free speech with money. 'Those who've got it get the freedom of speech, those who don't got the right to shut up,' he said.

However, Barry Lynn, legislative counsel for the American Civil Liberties Union, told the committee that the Supreme Court was right on the mark in Buckley v. Valeo, and any attempt by Congress to limit campaign spending, whether by individuals or political action committees, would be unconstitutional. 'Such reform would inhibit people from exercising their freedom of speech,' he said. Barry said that the ACLU would like to see all current limits on campaign spending removed, believing that public financing of federal elections, rather than spending limits, is the answer to the question of influence-buying raised by PACs and other large contributors.

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He also said that the ACLU in particular opposes two campaign reform bills under consideration this year, S 7, which would limit PAC contributions and S 137, which would set up a voluntary system of spending limits. These bills would "unduly restrict the right of people to make money and to spend it," he said.

A system of total public financing was proposed by Randall Kehler, co-director of the Study Group on Electoral Democracy, a non-profit campaign research group. The public funds could come from a \$5 or \$6 annual tax surcharge on each taxpayer, he suggested.

PACs should not be seen as an "evil" influence on politicians, James T. Christy, a member of the board of directors of the National Association of Business Political Action Committees said. Rather, PACs provide individuals who want to be involved in the political process but can only afford a small contribution to participate in an election, he said. While some PACs may represent people united by a common view on a particular issue, they are not seeking to buy influence, he told the committee.

The amount spent on campaigns is not so much a problem as are the unfair advantages which incumbents have over challengers, according to Michael D. Brown and David A. Stewart, co-chairman of the Coalition to End the Permanent Congress, a group composed of individuals who have unsuccessfully challenged congressional incumbents. Franking privileges, campaign war chests, and honoraria, along with access to the media all help to give incumbents an unfair edge over challengers and should be done away with by Congress, they said.

2ND STORY of Level 1 printed in FULL format.

Copyright (c) 1989 The Bureau of National Affairs, Inc.;
Daily Report for Executives

June 23, 1989, Friday

SECTION: REGULATION, ECONOMICS AND LAW; DER No. 120

LENGTH: 1021 words

HEADLINE: Federal Elections, BUSH TO DECIDE ON ELECTION REFORM PLAN, PAC
LIMITATION OPPOSED BY BUSINESS GROUPS

BODY:

Despite protests from Washington lobbyists, President Bush is stick to his position that political action committees for corporations, trade associations and unions should not contribute to political candidates, according to sources within and outside the administration.

The president is expected to decide next week on a promised package of election reform proposals, and business lobbyists are lamenting the likelihood that Bush will not be dissuaded from his PAC reform proposal.

The PAC limitation will be only a part of the Bush reform package, administration officials emphasize, but it will affect millions of dollars in PAC contributions. In the 1988 election cycle, total PAC contributions to candidates were about \$160 million, of which \$140 million came the "connected" PACs, run by corporations, associations and unions, as opposed to those "unconnected" PACs, operated by issue groups.

Business groups in particular have been lobbying the White House in opposition to the Bush idea of cutting off their contributions to candidates, although not to political parties. Opponents argue that the the idea will have the unintended consequences such as increasing hidden campaign contributions.

But Bush, who announced his predilection on the subject April 12, is expected to stick to his guns, despite misgivings by some on his own staff. Bush in his April 12 ethics speech argued that PACs "weaken the parties, restrain competition and deaden the political debate." (70 DER A-12, 4/13/89).

Business representatives, and others active in the world of campaign reform, will have a chance next week to make their arguments to Bush personally next week, according to White House officials who are planning several of the pre-decisional meetings Bush has taken to holding as he considers major policies.

A final staff options paper will be delivered to Bush soon, and his decisions may be announced as early as the end of the week. White House officials stress that the proposal will be comprehensive. Besides dealing with PAC issues, the president's plan is expected to propose more disclosure of "soft money" donations and ways to offset the advantages of incumbency. Sources also said the president is likely to suggest restrictions to prevent the "roll-over" of contributions for personal use, or for political war chests. Serious consideration is being to limiting the franking privilege.

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Also next week, according to Capitol Hill sources, the National Republican Congressional Committee will reveal its own campaign finance proposal.

The expected flurry of activity comes despite the increasingly conventional view on all sides of the debate that strong partisan differences on campaign finance will yield a legislative impasse.

Business Reaction

In meetings with White House officials, the pro-PAC position has been argued by representatives of the National Association of Manufacturers, the U.S. Chamber of Commerce, and the National Association of Business Political Action Committees, among others.

'I don't think we can talk then out of the basic proposition of having the PACs contribute only to the parties,' concluded Teri Pierce, director of public affairs for the Chamber.

NABPAC consultant Steven F. Stockmeyer, 'I think he is dead wrong on it, and as near as I can tell it is a long-held personal view of his own.'

'I would not say the prognosis is good that the bill the president will send up will extract the PAC language,' according to Jean Herbage, NAM's director of political education.

Herbage said, 'Business supports political action committees and we do not appreciate the effort to further curtail the use of PACs.' She added, 'We believe it is a legitimate vehicle for corporations to involve their employees in the political process.'

One White House official speaking on background said Washington lobbyists feel more strongly about the issue than do corporate executives. And a House intimate of the campaign finance debate who declined to be identified said, 'The Washington reps and PAC managers are reeling in horror, but the CEOs are saying please save us from this headache.'

Unintended Consequences?

Among the arguments being advanced against the expected presidential proposal on PACs is that businesses will react by making 'independent' expenditures on a candidate's behalf, or by 'bundling' donations to candidates—the practice of having one person collect individual checks.

'If you close off that avenue [PACs], which is fully disclosed and limited, you invite people to find other ways to impact the process or satisfy the insatiable demands of incumbents for campaign funds,' Stockmeyer said. He also contends that Bush's limitation would narrow the focus of corporate

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donations, asking, "If we are worried about undue influence why would you want to narrow it?"

Stockmeyer also raised doubts about making a distinction between connected and unconnected groups, wondering when limitations will violate constitutional protections. He said the administration "probably is getting a lot of flack from right wing groups who are astounded a Republican administration would even be thinking along these lines, and at a minimum want to be carved out themselves."

In addition, criticism is leveled at the assumption that prohibiting contributions by connected PACs to candidates will increase PAC contributions to political parties. "It is just not going to happen," Herbage predicted, because the PACs will not feel they had "a voice" in the political process.

The 16-point NABPAC alternative for campaign reform would, among other things, eliminate "leadership PACs" sponsored by congressional leaders and used to channel funds to candidates. NABPAC would not place any further limitations on PAC contributions, but would increase individual contribution limits and would index all contributions to inflation. NABPAC also is proposing a 100 percent tax credit for contributions up to \$100.

4TH STORY of Level 1 printed in FULL format.

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June 19, 1989, Monday, NORTH SPORTS FINAL EDITION

SECTION: NEWS; Pg. 1; ZONE: C

LENGTH: 1572 words

HEADLINE: Money makes reform a tough sell in Congress

SERIES: First of two articles.

BYLINE: By Elaine S. Povich, Chicago Tribune

DATELINE: WASHINGTON

BODY:

Sen. David Boren of Oklahoma says a U.S. senator has to raise \$15,000 every week he's in office just to obtain enough money to get re-elected.

That works out to more than \$2,100 a day, or about \$90 every hour night and day for six years, to finance the average \$4.5 million cost of a Senate re-election campaign.

The huge sum is part of the reason members of Congress designed an intricate and perfectly legal system of rules over the years to funnel vast amounts of money to themselves for their campaigns. And some of this money ends up for their personal use.

"Members are under tremendous pressure to raise money. It opens the door to the special interests," said Boren, a Democrat and author of several campaign reform bills. "There's no way you can forget that a lobbyist contributed \$5,000 to your political campaign."

From a personal-finance standpoint, it's also hard to forget a \$2,000 speaking fee that a member of Congress gets from a special-interest group. And the system of laws now in place makes acceptance of such fees legal, though the total amount of allowable fees is capped each year.

This spring, the entire money-making system has come under extraordinary scrutiny because of the resignations of House Speaker Jim Wright (D., Tex.) and Majority Whip Tony Coelho (D., Calif.). Wright was accused of padding his legitimate income with book sales that may have circumvented House rules, which form part of the system, and Coelho was discovered to have received financial help from a savings and loan official so he could buy \$100,000 in speculative bonds.

Debate on the ethics issue is expected throughout the summer and into fall. The House and Senate have appointed task forces to look into campaign financing and income earned by members of Congress. But getting some reforms that a majority can agree to is seen as extremely difficult. Legislation to limit lobbying by former members of Congress, which was vetoed by former President

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Reagan, is most likely to get early approval. President Bush seems to look more favorably on it.

The overall money-gathering involves pay and other earned income as well as campaign financing.

In addition to their \$89,500 annual pay, senators are allowed up to 40 percent more in outside earned income, most of which comes from making speeches to groups with a special interest in legislation before Congress. House members can receive up to 30 percent more of their salary.

Members of Congress are prohibited from keeping more than that amount, but those who earn more can donate the rest to charity and count the total toward retirement benefits.

In addition, members of Congress augment their pay with free travel to and from their districts and speaking engagements and with free mailings of "official" communications, including letters to the folks back home and "newsletters" outlining their accomplishments.

For campaigning, there is no lack of those willing to provide cash. Nearly every night that Congress is in session there are dozens of receptions, cocktail parties and fundraisers where political action committees (PACs) from industry and interest groups scout out recipients.

Fred Wertheimer, president of Common Cause, the citizen lobby that supports fundraising reform, said the system "means you have to sell yourself to the PACs. It is a system in which you are linked to lobbyists by money."

The system favors incumbents, which may explain why 98 percent of the members of Congress who have sought re-election in recent years have been successful. It also helps to explain why the system is so tough to dislodge. While many Americans are cynical about Congress, only a major issue like the Watergate scandal or Wright's resignation is enough to shake Congress itself into thinking about doing something about the system.

"There has never been a time in American history when there has been a total lack of skepticism and even cynicism about elected officials," said Senate Majority Leader George Mitchell (D., Me.), who hopes to address the money issues in this Congress.

"Interest (in ethics) rises and falls," Mitchell said. "The interest is high now as a consequence of . . . the changing social climate generally."

Currently, PACs can contribute \$5,000 per candidate per campaign. That's really not a lot of money in comparison to what may be gained. Congressional observers note that a few tens of thousands in donations is a relatively small investment by the defense industry, for instance, in return for some attention when billions of dollars in weapons systems are being discussed.

The campaign financing system also allows those elected before 1980 to leave Congress and take with them all the campaign funds they raised but did not spend.

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For instance, when Wright leaves Congress, he will take \$83,843 with him from his campaign war chest, and Coelho leaves with \$79,049, according to the Federal Election Commission.

Those totals are small, however, compared to some others. Rep. Dan Rostenkowski (D., Ill.) has in excess of \$1 million in a campaign kitty and Rep. Steven Solarz (D., N.Y.) has \$1.5 million. Neither has had a close election in years, and their huge cash reserves could be a reason no one is willing to challenge them.

The most likely target for reform is outside earned income. Most members of Congress favor prohibiting such income, which comes largely from giving a speech and is labeled an "honorarium," in return for a pay raise of 30 or 40 percent. But they are skittish, and sometimes downright angry, about the huge negative reaction earlier this year to a proposed 51 percent pay raise and an unspoken nod to giving up honorariums in return.

"Most people trashed that idea," said an obviously bitter Rep. David Obey (D., Wis.), who backed the pay raise in return for the end to honorariums. "Twice as many are opposed to the pay raise as are opposed to honoraria."

Obey, the author of a 1977 law that limits outside earned income, said the move last January to increase salaries and ban honorariums was "an attempt to finish the job, and we had our heads handed to us."

While Republicans and Democrats are in the same boat on pay, they tend to split on PACs and campaign financing. Money raised by congressional candidates has more than doubled from the 1977-78 election years to the 1985-86 cycle, to \$472 million from \$199 million.

Part of the increase in cost is because of higher prices generally, especially for TV commercials, and part of the increase is due to better organization by the PACs, which contributed about 30 percent of the recent total.

In the Democrat-dominated House, Republican challengers complain the loudest about PACs. But in fact, it was the Republicans who first benefited from the PACs. In the late 1970s and early 1980s, the National Conservative Political Action Committee perfected negative campaigning, mostly against Democrats.

Now, the Democrats have made inroads in the PAC community. Coelho, a former chairman of the Democratic Congressional Campaign Committee, was the first to attract really big money to the Democrats.

"There has been a clear change in how the parties view PACs," said Rep. Al Swift (D., Wash.), who has sponsored legislation to limit PAC financing and campaign expenditures in general. "Earlier, it was the Democrats denouncing them and the Republicans supporting them. Democrats feared these PACs would favor Republicans, and Republicans felt the same. In recent history, Democrats have done better at collecting (money from) PACs."

Last year, after a record unsuccessful eight cloture votes to cut off debate, the Senate failed to break a GOP-led filibuster against a campaign finance bill that would have set state-by-state Senate campaign spending limits. Republicans, backed by the PACs, led the opposition.

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"We need a way to stop the spending . . . race," said Wertheimer of Common Cause, which has led proponents of campaign financing reform and is in the forefront of recent efforts to change the system. "We need to shut down the system where outside interests can use money to buy influence."

Tuesday: The difficulties facing meaningful ethics and campaign reform in Congress.

PAC contributions and congressional honoraria
Political action committee contributions
In millions of dollars per campaign year
U.S. Senate, U.S. House, 1977-88

Leading honoraria recipients in U.S. House
In dollars in 1988

Name	Total honoraria	Amount kept
Dan Rostenkowski (D., Ill.)	\$222,500	\$25,885
Pat Schroeder (D., Colo.)	114,376	26,160
William Gray (D., Pa.)	110,788	24,100
Tony Coelho (D., Calif.)	90,100	26,525
Willis Gradison (R., Ohio)	88,650	26,250
Henry Waxman (D., Calif.)	71,750	26,021
Robert Michel (R., ILL.)	60,500	29,600
Bill Frensel (R. Minn.)	60,200	25,800
Tom Luken (D., Ohio)	54,600	25,841
Robert Matsui (D., Calif.)	53,500	26,850
Average of 379 members	15,517	12,609

GRAPHIC:

Chicago Tribune Graphic; Source: U.S Federal Election Commission and Common Cause.

TERMS: SERIES; CONGRESS; OFFICIAL; SALARY; NAMELIST; RANKING; ETHICS; CAMPAIGN; FINANCE; ANALYSIS

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Document No. 045057 SS

WHITE HOUSE STAFFING MEMORANDUM

DATE: 6/15/89 ACTION/CONCURRENCE/COMMENT DUE BY: 5:00 PM 6/20/89

SUBJECT: CAMPAIGN FINANCE REFORM PACKAGE

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SCOWCROFT	<input type="checkbox"/>	<input type="checkbox"/>	PORTER	<input checked="" type="checkbox"/>	<input type="checkbox"/>
DARMAN	<input checked="" type="checkbox"/>	<input type="checkbox"/>	STUDDERT	<input type="checkbox"/>	<input type="checkbox"/>
BATES	<input checked="" type="checkbox"/>	<input type="checkbox"/>	UNTERMAYER	<input type="checkbox"/>	<input type="checkbox"/>
BREEDEN	<input type="checkbox"/>	<input type="checkbox"/>	WRAY	<input checked="" type="checkbox"/>	<input type="checkbox"/>
CARD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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GRAY	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
HAGIN	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS: Please forward any comments to C. Boyden Gray, 2nd Fl., WW, no later than 5:00 PM, Monday, June 20, 1989, with an info copy to my office. Thank you.

RESPONSE:

CLOSE HOLD

James W. Cicconi
Assistant to the President
and Deputy to the Chief of Staff
Ext. 2702

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01. Memo	C. Boyden Gray to POTUS, Re: Campaign Finance Reform Package. (14 pp.)	06/14/89	P5	

Collection:

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Date Closed: 12/13/2004	OA/ID Number: 13872-014
FOIA/SYS Case #: S	Appeal Case #:
Re-review Case #: 2005-0481-S	Appeal Disposition:
P-2/P-5 Review Case #:	Disposition Date:
AR Case #:	MR Case #:
AR Disposition:	MR Disposition:
AR Disposition Date:	MR Disposition Date:

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P-1 National Security Classified Information [(a)(1) of the PRA]
- P-2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P-3 Release would violate a Federal statute [(a)(3) of the PRA]
- P-4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P-5 Release would disclose confidential advice between the President and his advisors, or between such advisors [(a)(5) of the PRA]
- P-6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Removed as a personal record misfile.

Freedom of Information Act - [5 U.S.C. 552(b)]

- (b)(1) National security classified information [(b)(1) of the FOIA]
- (b)(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
- (b)(3) Release would violate a Federal statute [(b)(3) of the FOIA]
- (b)(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
- (b)(6) Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
- (b)(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- (b)(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- (b)(9) Release would disclose geological or geophysical information

CLOSE HOLD

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DRAFT

June 14, 1989

MEMORANDUM FOR THE PRESIDENT

FROM: C. Boyden Gray, Counsel to the President
White House Campaign Finance Reform Working Group

SUBJECT: CAMPAIGN FINANCE REFORM PACKAGE

ACTION-FORCING EVENT

In your April 12 address to the American Society of Newspaper Editors, you announced that you had instructed your staff to perform a comprehensive review of campaign finance reform. This memorandum is a product of such a review by a White House working group which included representatives from the Offices of Counsel to the President, Political Affairs, Policy Development, Legislative Affairs, and the Republican National Committee (the "Working Group"). The Working Group has met periodically over the past two months, both on its own to consider various proposals, and with representatives from the Senate, the House, corporate and trade association PACs, ideological groups, and Republican political professionals.

The meetings with the various constituency groups produced a consensus from Republican partisans that the President's package should be an innovative measure which breaks through the Republican "fat cat" stereotype and takes cutting edge positions on specific issues for which there may not yet be a consensus on the Hill because of the self-interests of various Members.

Our starting point for the proposals outlined below was the four points articulated in your April 12 speech. First, you announced that the Administration's ethics bill which went to the Hill that day would include a prohibition against converting congressional campaign funds to personal or office use. Second, you stressed the need to strengthen political parties. Third, you stated that, "I believe we should eliminate contributions to candidates by political action committees, and I'll be consulting with Congress about that." In that context, you noted that, "PACs weaken the parties, restrain competition, and deaden the political debate." Finally, you opposed public financing of

Congressional elections. The Working Group has attempted to develop a comprehensive campaign finance reform package which is consistent with your bold proposal on PACs and the general themes of strengthening parties, increasing competition and fairness in elections, and curtailing special interests.

Part of the backdrop for these deliberations is the burgeoning ethics crisis in the House which demonstrates the inherent dangers of a Congress too long dominated by one party. This crisis follows the 1988 elections in which 99.2% of the incumbents in the House who sought re-election were re-elected under a campaign finance system where 62% of PAC contributions went to Democrats and 76% went to incumbents. In elections between incumbent House Democrats and Republican challengers, the numbers are even more striking: Democrat incumbents received \$54.3 million in PAC contributions compared to the \$2.4 million for Republican challengers.

The Working Group has divided its proposals into four broad areas: (I) Contribution Limits by PACs, Political Parties and Individuals; (II) the Incumbency Advantage, including the use of excess campaign funds, the political advantages of holding office, and perpetuation of incumbency through redistricting; (III) Soft Money and the need for full disclosure, and (IV) Banning Honoraria.

I. CONTRIBUTION LIMITS

A. PACs

1. ANALYSIS

In your April 12 speech, you stated your belief that PAC contributions to candidates should be eliminated. Under current law, there are two general categories of PACs: those which are sponsored by, or affiliated with, corporations, unions and trade associations, and those which are not sponsored or affiliated, the so-called "non-connected" or "ideological" PACs. The bulk of PAC contributions come from corporate, union and trade association PACs: they accounted for nearly 90% of total PAC giving in 1988.

Because of freedom of association and freedom of expression guarantees found in the First Amendment, it may be impossible to ban all contributions to candidates from these non-connected PACs.

Our proposal is to ban corporate, union, and trade association PACs, which would return the law to its pre-Federal Election Campaign Act of 1971 status. In addition, we would reduce the contribution limit for the remaining non-connected PACs from \$5,000 to \$1,000 per candidate per election. This proposal would sharply reduce overall PAC giving. Using 1988 PAC contribution

figures, the effect of this proposal would have been to eliminate at least \$140 million of the \$160 million in PAC contributions.

If PAC contributions were curtailed as outlined above, other elements of this package become crucial since such a ban has the potential of: decreasing the role of business interests in the campaign finance system, thereby increasing the relative influence of labor unions; encouraging corporations, unions, and trade associations to "bundle" individual contributions through agents as a way to circumvent the limitation; and increasing the number of independent expenditures.

It should be noted that the Working Group does not believe this package will significantly affect the amount of money being spent on elections. Instead, the reforms proposed will tend to re-channel campaign funds.

2. RECOMMENDATIONS

In order to achieve your objectives while creating a sound overall system for campaign finance, the Working Group recommends reforms in five specific areas: (a) banning corporate, union and trade association PACs; (b) prohibiting candidates from having more than one committee in order to end "leadership PACs"; (c) tightening rules prohibiting economic special interests from "bundling" individual contributions; (d) codifying the Beck Supreme Court decision on union dues; (e) encouraging voter participation programs by economic special interests, and (f) increased reporting for independent expenditures.

Because change to one part of the campaign finance system has consequences for other parts of the system as well, the Working Group strongly recommends that all six reforms be undertaken as a uniform package to lessen the risk of unintended consequences.

a) Banning PACs: The Working Group recommends eliminating corporate, union, and trade association PACs. This would include prohibiting any union, corporation, or trade association from using its treasury money to pay for any PAC's administrative costs or other political activities. It would also abolish any payroll checkoff contributions to any PAC. Contributions by the remaining non-connected PACs would be reduced from \$5,000 to \$1,000 per candidate per election. These non-connected PACs would continue to be allowed to contribute \$15,000 per year to national and \$5,000 per year to state political parties in order to strengthen the political party structure. Further, the non-connected PACs would be able to continue spending unlimited amounts of money on such participatory activities as voter registration programs, informing members and the public about elections, and conducting get-out-the-vote activities. All such

activities would be fully reported and would provide those PACs remaining a vehicle to participate meaningfully in the electoral process.

- Pro: -- Reduces the role of economic special interest money.
- Pro: -- Increases the role of political parties since the role of PACs will diminish.
- Pro: -- Equalizes the roles of corporations and union in elections.
- Pro: -- Takes the high ground on PACs which, in this ethics climate, is likely to be popular with the public and press.
- Con: -- Eliminating corporate, union and trade association PACs may reduce the number of individuals currently participating in the system since many individuals give only to their company's, union's or industry's PAC.
- Con: -- Danger that cutting off PAC contributions to candidates will tend to increase independent expenditures and encourage "bundling" abuse.
- Con: -- May not lead to increased PAC giving to political parties, because many PACs believe they receive benefits only by giving directly to candidates.

DECISION -- PAC Contributions

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

b) "Leadership PACs": We recommend that any legislation also prohibit transfers between PACs and limit all candidates to a single committee. This would ban "leadership PACs" which allow entrenched incumbents to spread special interest contributions to other candidates.

- Pro: -- Discourages the proliferation of non-connected PACs that may otherwise occur if economic special interest PACs are banned.

- Pro: -- Stops influential congressional leaders from using economic special interest money to fund their personal PACs so they can seek favor from their colleagues.
- Pro: -- Reform initially recommended by the PAC community.
- Con: -- Opposition from those congressional leaders who have raised and spent significant amounts in seeking and maintaining positions in the congressional leadership.

DECISION -- Leadership PACs

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

c) Bundling: Bundling is the practice where an organization (or its officials) solicits many contributions from its employees or members at a central location, bundles them together and sends them to the candidate without affecting the central organization's contribution limits. We recommend tightening the existing laws prohibiting bundling, except that such restrictions would not apply to political parties.

- Pro: -- Necessary to discourage economic special interests from doing what their PACs did by instead having corporate executives and union and trade association officials pressure their colleagues for individual contributions.
- Con: -- It may be impossible to legislate away this practice, so that money from economic self-interests will still play a major role despite PAC reform.

DECISION -- Bundling

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

d) Beck Codification: The U.S. Supreme Court decision in Beck should be codified so that a union member can stop his or her mandatory dues from being used for political activities he or she does not support. (This proposal received virtually unanimous support from all individuals talked to by the Working Group.)

- Pro: -- Levels the playing field between union and corporate interests.
- Pro: -- Unanimously supported by all outside groups contacted by the Working Group.
- Con: -- Ensures strong opposition from organized labor because of Beck codification (in conjunction with the prohibition on labor treasury money for PAC administrative costs).

DECISION -- Beck Codification

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

e) Voter Participation Programs: Although corporations, unions, and trade associations would not be permitted to sponsor PACs, these entities would continue to be permitted to participate in elections through voter registration programs, get-out-the-vote activities and advocacy communications to their members. However, this proposal would require full disclosure of all monies spent for such activities. Under current law, such activities are frequently not disclosed, resulting in massive amounts of political activity and spending outside the scrutiny of the public and the media.

- Pro: -- Encourages voter participation activities by corporations, unions and trade associations, which could lead to increased turnout.
- Pro: -- Increases disclosure of activities which affect elections.
- Con: -- Corporations and unions (and their employees and members) may not participate in the political process if they cannot contribute directly to candidates.

Check notes

DECISION -- Voter Participation Programs

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

(f) Independent Expenditures: Reporting requirements for any group conducting independent expenditures would be increased. Specifically, such groups would be required to include additional notice throughout an ad identifying the person or organization funding it. Timely notice, in advance, to all candidates of the independent expenditure would be required, along with a hearing before the FEC within 3 days of a complaint of collusion between an independent expenditure committee and a candidate. The Supreme Court has ruled that independent expenditures are constitutionally protected, so an airtight ban is impossible. These reforms would make such expenditures more onerous and would allow victims of independent expenditures a public forum for counterattack.

- Pro: -- Provides a counterbalance to independent expenditures, which could well increase if economic special interest contributions to candidates are barred and other PAC contributions reduced.
- Pro: -- Independent expenditures will lose much of their strength if they must be reported in advance and if the victim has the right to a hearing immediately following the expenditure if there is any evidence of collusion with a candidate.
- Pro: -- Such restrictions enjoy bi-partisan support in Congress.
- Con: -- Restrictions on independent expenditures may have a chilling effect on legitimate political debate.

DECISION -- Independent Expenditures

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

B. POLITICAL PARTIES

1. ANALYSIS

The April 12 ethics speech stressed that political parties should be strengthened. As discussed above, proposed PAC limitations alone may allow the political parties to regain influence. Another way to strengthen political parties is to increase party spending limits through increased coordinated expenditures. This would also allow candidates to spend less time fundraising since a larger amount of their funds could come from one set source. Candidates would not be tainted by "special interest" money because any such funds would come from a political party, and candidates and contributors would have no way of knowing precisely which special interest's money were going to which campaign.

2. RECOMMENDATIONS

The Working Group recommends increasing the coordinated expenditure limits the parties may spend on behalf of congressional candidates to 5¢ times the voting age population of the state, adjusted for inflation (it is now 2¢ times the voting age population, adjusted for inflation). The Working Group also recommends that an individual's contributions to political party committees not count against that individual's \$25,000 annual limit. Both recommendations would provide additional funds for the political party committees to aid in their assuming a larger role in the process.

- Pro: -- Political parties would be strengthened because they will play a larger role in funding candidates.
- Pro: -- Candidates would spend less time fundraising because the parties can contribute more.
- Pro: -- Individual candidates would not be tainted by taking money from any one special interest since funds will be provided by the parties.
- Con: -- To the extent the RNC is perceived as having an upper hand in fundraising over the Democrats, you could open yourself to criticism that these recommendations simply represent political self-interest.

3. DECISION

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

II. REFORM THE INCUMBENCY ADVANTAGE

A. EXCESS CAMPAIGN FUNDS

1. ANALYSIS

Under the current law, incumbents amass huge war chests that scare off challengers in election after election, thereby insulating incumbents from competitive elections. These campaign treasuries are also put to other uses. In the House, the "grandfather clause" permits the 190 House Members in office on January 8, 1980 to convert their excess funds to personal use upon retirement. In the Senate, the Rules ban personal use of campaign funds, but permit the use of such funds to supplement official accounts.

As noted above, the ethics legislation sent to the Hill on April 12 included a provision prohibiting the conversion of excess campaign funds to personal or office use. This would stop House Members from converting excess campaign funds to personal use. It would also prohibit Senators from supplementing their official accounts with campaign funds. Republican and Democratic Senators now do this by direct disbursement of campaign funds to cover items that can also be paid for with official funds. Republican Senators also receive funds from the National Republican Senatorial Committee through the COMBO program account for the same purposes.

The issue has arisen as to whether we should go beyond the April 12 proposal and ban all uses for excess campaign funds.

2. RECOMMENDATIONS

The Working Group recommends zeroing out campaign treasuries after each election. This goes beyond the ethics package provisions, but is certainly not inconsistent with the prior

proposal or with the theme of increasing competition in elections. All excess campaign funds should be given to: national and state party committees; the National Debt Retirement Account of the United States Treasury; or all campaign contributors as pro-rated refunds. The proposal would require that all campaign accounts be zeroed out by January 31 following the election, except for purposes of retiring a campaign debt.

Pro: -- Eliminating campaign war chests will result in more competitive elections and higher turnover.

Con: -- Many Members of Congress feel strongly that this kind of "insurance fund" is necessary and appropriate.

DECISION

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

B. FUNDRAISING RESTRICTIONS

1. Analysis

In the interest of limiting the influence of economic special interests and decreasing the amount of time Members spend fundraising while in Washington, it has been proposed that Members of Congress be permitted to be involved personally in raising campaign funds only on calendar days when Congress is not in session. The Working Group has not reached a consensus recommendation on this option.

DECISION

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

C. ADVANTAGES OF HOLDING OFFICE

1. ANALYSIS

The incumbent re-election rate in the House of Representatives is over 99%; the re-election rate in the Senate is over 75%. As is frequently noted, there is more turnover in the Soviet Politburo than the U. S. Congress. Thirty-five years of Democratic rule in the House have contributed to the ethical quagmire in which the House is currently immersed.

This one-party domination is perpetuated by protections built in to the current system. The root of the problem is that incumbents -- especially in the House -- have used the system to shield themselves from the voters. The aim of this campaign reform package is to restore competitive elections. Accordingly, the package takes aim at the perquisites of office and the self-perpetuation of incumbents.

2. RECOMMENDATIONS

In order to promote fair and competitive elections and reform a scandal-tainted institution, reform should come in the areas of reduced Franking and redistricting.

a) The Frank: Limit the use of the Frank by putting a cap on the total amount available so that Members would be limited to one postal patron a year, mailed only in December, January, or February. (Option 1) This would allow a regular newsletter or survey, but would restrict campaigning at public expense. Another option is to ban Franked mass mailings of over 500 pieces so that individually addressed computer-generated letters to all residents of a District or State could not be used. (Option 2) A more drastic alternative would ban unsolicited Franked mail. (Option 3). Under any of the options, the Secretary of the Senate and Clerk of the House should be required to report quarterly on the amounts spent by each Member.

Pro: -- Any of these options will result in budget savings. The use of the Frank now costs the taxpayers over \$200 million a year.

Pro: -- The Frank is abused by incumbents at the taxpayers' expense.

Pro: -- There is no way for a challenger/candidate to respond to an incumbent's ability to use the Frank.

Con: -- Reduction of the Frank may reduce a Representative's ability to communicate with his constituents.

DECISION -- The Frank

- _____ Approve
- _____ Option 1 (1 annual postal patron)
- _____ Option 2 (ban mailings over 500 pieces)
- _____ Option 3 (ban unsolicited Franked mail)
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

b) Redistricting: No single factor is more basic to reforming the built-in advantages of incumbency than ensuring a fair redistricting. This can be achieved legislatively by drafting neutral criteria so that districts are drawn according to non-partisan factors based on fairness, rather than partisan self-perpetuation. While redistricting is often overlooked as a part of the campaign finance reform debate, a gross gerrymander insulates incumbents from the voters more than any other single factor. For example, the California gerrymander of the 1980's has led to only one seat changing parties in the 180 Congressional elections that have been held this decade.

Vast technological advances heighten, as never before, the chance of similar gerrymanders in the 1991 redistricting. A Presidential proposal endorsing non-partisan criteria based upon the preservation of communities and the compactness of districts is the single most important step Republicans can take to heighten public awareness of this crucial issue. This can be done by: 1) promulgating criteria for fair redistricting in federal elections, such as requiring district lines to follow established community boundaries and standards for compactness, and 2) emphasizing that Congressional and legislative districts must comply with the Voting Rights Act.

- Pro: -- Will heighten the awareness of this top-priority issue.
- Pro: -- This is a "good government" proposal which will be widely supported.
- Pro: -- It allows the President to show strong support for the provisions of the Voting Rights Act.

- Con: -- Redistricting is not usually seen as part of campaign finance reform so there may be skepticism as to motives.
- Con: -- Democrats will strongly oppose any fair districting criteria since they hold most of the political cards and see neutral criteria as an attack on their political power base.

DECISION -- Redistricting

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

III. SOFT MONEY

1. ANALYSIS

The basic premise behind the campaign finance laws is full disclosure. However, a significant portion of the monies spent in American elections today is not disclosed. Republicans have always argued for full disclosure, and the President can demonstrate this commitment again in this package.

Full disclosure should aim at two areas. First is the well-publicized soft money fundraising in the Presidential campaign. The RNC has already voluntarily publicly disclosed all of its Team 100 and other soft money contributions. The Democrats have not been so forthcoming. Public pressure is such that full disclosure of soft money is inevitable -- and we should take the initiative on this.

The focus on presidential political party soft money is only part of the story, however. The same principles behind party soft money disclosure should apply to the undisclosed political activity of labor unions and tax-exempt groups (an estimated \$20 million was spent by unions in the 1984 presidential race on behalf of Democratic candidates).

2. RECOMMENDATIONS

First, there must be the full disclosure of all soft money contributions and expenditures by political party committees. Second (as discussed above in I. A. 2, P. 2), all labor unions,

corporations and trade associations must disclose fully all money spent to influence a federal election, including voter registration and get-out-the-vote activities, as well as any communications which advocate the election or defeat of any federal candidate.

- Pro: -- Full disclosure is a good government proposal that will be popular in the press and among the public.
- Pro: -- The Democrats and their allies abuse the current soft money rules far more than Republicans.
- Con: -- The unions will strongly oppose the disclosure of their soft money activities.
- Con: -- Some Republican donors may complain at having their contributions made public.

3. DECISION

- _____ Approve
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action

IV. HONORARIA

1. ANALYSIS

The Working Group recommends that you consider a ban on honoraria. In your April 12 speech you stated that you believe honoraria for Members of Congress should be banned. You also stated that you believe Members of Congress should receive a pay raise and that you would not "make a formal proposal to Congress until after I consult with the leaders of Congress on the issue of Congressional pay."

The Working Group believes that this campaign finance reform package is an appropriate vehicle to propose a ban on honoraria. Especially because of recent events on the Hill, such a proposal would be timely. We do not recommend that a pay raise be included in the proposed legislation. (However, statements accompanying the announcement could make the link to a pay raise.)

The two principal options which have emerged are: (1) the immediate banning of honoraria, and (2) a phased-in approach,

whereby the percentage of a Member's salary which may be accepted as honoraria is reduced over time. Currently, House Members may retain honoraria fees in an amount equal to 30% of their salaries, while Senators may accept 40% of their salaries in such fees.

2. RECOMMENDATIONS

The Working Group recommends that the legislation include an outright ban on honoraria, effective upon the date of enactment.

- Pro: -- Takes a bold and popular stand on an issue which is currently in the limelight.
- Con: -- May be resented by some Members of Congress, especially if it is not coupled with a pay increase.

3. DECISION -- Ban Honoraria

- _____ Approve
- _____ Option 1 (immediate ban)
- _____ Option 2 (reduced over time)
- _____ Approve as Amended
- _____ Disapprove
- _____ No Action