

Accountability Issues of the Resolution Trust Corporation

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Abstract

No other governmental organization ever created can rival the complex patterns of accountability created to manage the bailout of the savings and loan industry. This complexity has, in turn, led to criticism that the bailout structure is too unwieldy to be managerially effective or politically accountable. While the structure does indeed immensely complicate these problems, it is an inevitable product of the political realities that shaped the bailout strategy. The real issues in maintaining accountability to the public for the bailout are: reporting clearly on how the money is being used; improving Congress's ability to track the complex management of the bailout; and using government officials, not contractors, to supervise the government's goals. Indeed, the biggest potential problem of accountability in the savings and loan rescue is not the convoluted political structure at the top but the heavy reliance on private contractors at the bottom.

Introduction

In the 20th century, the savings and loan (S&L) crisis rivals only the bank failures of the Great Depression and the hyperinflation of the 1970s in threatening Americans' confidence in their financial institutions. The thrift rescue launched by Congress and the Bush administration in 1989, moreover, promises to be the largest financial bailout ever attempted. The U.S. General Accounting Office (GAO) estimates that at least \$325 billion—probably much more, and at worst perhaps \$500 billion—will be needed during the next 30 years to fund the bailout.¹

To the American public, the crisis has many villains but none upon whom clearly to pin the blame. Massive fraud riddled the thrift industry in the 1980s. L. William Seidman, chairman of the Federal Deposit Insurance Corporation (FDIC) and, under the act, the head of the bailout, has said that fraud was discovered in 60 percent of the thrifts seized by the federal government in 1989, three times higher than the rate in commercial bank failures.² No financial problem since the Depression has received the public and media attention focused on the bailout.

Because there are no clearly identified villains, and because nearly all the major players—in the thrift industry, Congress, the executive branch, and the White House—are entangled in the crisis, the problems of accountability have multiplied. The American public is deeply suspicious of nearly everyone involved. The long-run financial costs are enormous and the public's anger and disgust are high. If the absence of clear villains shields everyone from direct blame, it also threatens everyone with great political risk.

These issues, in turn, shape the environment for accountability within the bailout. The strongest incentives for everyone involved, especially members of Congress and of the Bush administration, are to maintain control (to prevent the problems from getting worse) without assuming responsibility. The result is a peculiarly organized bailout structure in which everyone has a voice but no one is clearly in charge. Although it is a monstrosity by any standard of administrative efficiency, the structure matches the political incentives of the key players.

Compared with earlier financial disasters, the S&L crisis has two distinctive characteristics. First, unlike the previous emergencies that swept the country, the S&L crisis is geographically concentrated. No earlier disaster on the scale of the S&L crisis centered so directly on a single region. That concentration, in turn, has created unique politics about resolving the crisis. Of the 262 S&Ls under supervision by the FDIC in March 1989, for example, nearly half were concentrated in California, Louisiana, and Texas.³ For most members of Congress, the S&L problem was something occurring in someone else's district, and winning a place on their crowded agenda was difficult. Without widespread damage, it has taken longer to energize decision makers—in both the executive and legislative branches—to confront the problem.

Second, unlike the earlier disasters, the S&L crisis has required the commitment of enormous federal resources. The creation of deposit insurance in the 1930s helped shore up the banking system, and the Federal Reserve's war on inflation in the early 1980s convinced citizens that spiraling inflation would not continue. Although the political stakes and struggles in each of these crises were enormous, neither demanded the commitment of massive amounts of federal tax dollars. The S&L rescue is also aimed at restoring public confidence but, in contrast to the earlier crises, it also demands the outlay, in a highly charged political environment, of serious amounts of federal cash.

These features raise additional problems of accountability. Because the bailout is a huge but largely regional problem, it promises future battles over just who will benefit. Economists have argued that the costs of the bailout will be a financial wash: the money raised will be returned to taxpayers' pockets. While true in an economic sense, this argument misses two important political realities. First, many taxpayers are infuriated that they will be taxed to repay funds that, in their view, were stolen by unscrupulous thrift managers. Taxpayers may well be hunting for the scalps of those they believe cheated them. Second, because the problem is geographically focused, the bailout will mean the redistribution of enormous funds from a large number of states to a very few. The bailout thus will produce significant changes in regional economies, but the changes will be extremely difficult to forecast.

Dealing with these issues involves a difficult tradeoff. The organizations attempting to sell off the assets of troubled banks need the maximum amount of flexibility possible. Yet, because of the federal government's huge financial stake in the operation, elected officials need broad control to ensure that the process neither risks the federal government's finances nor narrowly benefits interested parties.

Thus, the S&L rescue created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989⁴ is a watershed event in the financial history of the United States. The act is aimed at resolving a crisis of historic proportions. The operations of the organizations created to reorganize the thrift industry function in a unique political environment. Finally, the tradeoffs involved in that function are unusually sharp, and costs of economic and political failure are unusually high. It is little wonder, then, that in structuring the rescue Congress devised an incredibly complex system.

What kind of organization?

Congress created two new organizations to effect the S&L rescue: the Resolution Funding Corporation (REFCORP), a government-sponsored enterprise, to raise the money required to liquidate troubled thrifts; and the Resolution Trust Corporation (RTC), a mixed-ownership government corporation, to manage the liquidations.⁵

Features of REFCORP

Through REFCORP, the federal government will sell \$30 billion in long-term bonds to raise some of the money needed to resolve the assets of the troubled thrifts.⁶ The bonds will be repaid through purchase of zero coupon bonds that mature at the same time as the REFCORP's other obligations. The Treasury guarantees payment of interest (but not the principal) of REFCORP's obligations. Retained and future earnings of the Federal Home Loan Banks (FHLBs), income from assessments on thrifts' deposits, and proceeds from the sale of assets from the failed thrifts will finance the purchase of the zero coupon securities. The Treasury (and hence taxpayers) will make no contribution to the principal.

REFCORP will operate under the supervision of a directorate composed of the director of finance for the Federal Home Loan Bank Board (FHLBB) and two presidents of regional FHLBs. It has no employees and its finances are off-budget. The enterprise's sole purpose is to borrow funds with which RTC can liquidate the thrifts.

Features of RTC

The RTC, by contrast, is a government corporation whose finances are on-budget. Congress empowered the RTC to take possession of all S&Ls that were insolvent on January 1, 1989, except thrifts that had been put into receivership by the Federal Savings & Loan Insurance Corporation (FSLIC) by that date. The RTC also would add to its caseload all thrifts that the Office of Thrift Supervision (OTS)—also created by the 1989 act—declared insolvent and took into conservatorship. However, transferring the thrifts to RTC was not automatic, and in the first months of the bailout it was not clear which institutions OTS would target for conservatorship. Drafters of the bailout had been concerned about the mingling of insurance and regulatory functions in the FHLBB, and they hoped this scheme would ease those worries. Some critics fretted that OTS might forestall putting more institutions under RTC's conservatorship than OTS and RTC mutually believed could be reasonably handled with the available funds. To the degree this occurred, the boundaries intended in the act would be blurred.

The RTC's operations will automatically end before December 31, 1996.⁷ RTC has no employees of its own. Instead, it will use employees from the FDIC and private contractors to liquidate the assets.

Goals

The RTC is responsible for managing and disposing of the assets held by these thrifts. Its job is to get the largest possible return for the government from the sale of the assets but also to sell the assets as quickly as possible. This dual requirement is, of course, a conundrum. Selling the assets quickly would minimize the government's costs but depress local real estate markets. Realizing the maximum return might mean selling assets gradually, but it would increase interest payments on the money borrowed and thus drive up the costs of the bailout.

Congress also mandated that RTC maximize "the preservation of the availability and affordability of residential real property for low- and moderate-income individuals." This low- and moderate-income focus is a familiar one in federal housing legislation, but it further complicates RTC's task. RTC must worry not only about how to achieve the best yield for the assets it manages but also about what the distributional effects of its decisions are.

Financing

Congress initially authorized \$50 billion to cover the federal government's initial losses in the rescue plan. It appropriated \$18.8 billion from the Treasury for fiscal year (FY) 1989 and transferred \$1.2 billion from retained earnings of the regional FHLBs. The remaining \$30 billion was to come from REFCORP. Through clever fiscal maneuvering, none of the money was expected to affect directly the Gramm-Rudman balanced-budget process.

The Office of Management and Budget (OMB) estimated that all of the \$20 billion appropriated for FY 1989 would be spent before the end of the fiscal year. Hence, it would not affect the next round of Gramm-Rudman calculations for FY 1990. In fact, only about half of the \$20 billion appropriated for FY 1989 was actually spent during that year. By the time RTC officials determined when the money would be spent, however, OMB had already taken its "snapshot" of FY 1990 spending. Under the Gramm-Rudman law, adjustments are not permitted for technical reestimates, and so the rescue avoided triggering Gramm-Rudman for its first year.

In subsequent years, RTC's funding was to come from the money raised by REFCORP, which would use the money it borrowed to make equity investments in RTC in exchange for nonvoting capital

certificates. Congress and the Bush administration agreed on this plan to keep RTC financing deficit-neutral. When REFCORP transferred money to RTC, it would be counted as a government receipt. RTC would then use that money to resolve troubled thrifts, and these expenditures would be counted as outlays. Because these amounts were expected to match, there would be no net effect on the budget or on the Gramm-Rudman process. This peculiarly mixed funding package was a compromise between the Bush administration, which wanted to keep RTC's funding completely off-budget, and congressional Democrats, who argued that the funding should be on-budget but, for the purposes of fiscal policy, should be specifically exempt from the budget totals used to determine the Gramm-Rudman sequestration amounts.

RTC officials, however, quickly discovered several major problems with the financing plan. RTC's finances can be divided into four parts:

1. RTC's administrative costs.
2. Net losses—the assets of failed thrifts that cannot be sold and thus must be absorbed by the government.
3. Working capital—money required to pay off the assets of thrifts placed under RTC's conservatorship until the assets can be sold, or “resolved.”⁸
4. Interest—the cost of money borrowed to repay the zero-coupon bonds and to fund the working capital.

Almost immediately, RTC officials determined that the initial \$50 billion would not be nearly enough to cover the federal government's net losses. The rescue would have to include many more thrifts, holding more valueless assets, than first hoped. GAO, in fact, estimated that the federal government would have to assume an extra \$13 billion (or a total of \$63 billion) in net losses.⁹

RTC officials also discovered that they would need far more working capital than first estimated. Simply gearing up to begin work took time. Finding bidders for all the assets under RTC control also proved more difficult than first hoped. Therefore, many of the RTC's assets would have to remain under RTC's management until buyers could be found, and RTC would need to borrow substantial sums to provide working capital. The amount of working capital was certain

to be large—perhaps approaching \$100 billion—but uncertain, because the total would be determined by how fast RTC managed to sell the assets.¹⁰ Table 1 lists GAO’s most conservative estimate of the bailout’s costs. GAO calculated, if the economy slows or if interest rates rise, the best-case total of \$325 billion could rise as high as \$500 billion.

Table 1. Estimated Minimum Cost of the Bailout
(amounts in billions of dollars)

Administrative costs	\$ 28
Net losses	\$155
Interest: bond payments	\$105
Interest: working capital	\$ 28
Other costs*	\$ 9
Total	\$325

Source: Statement of Charles A. Bowsher, “Resolving the Savings and Loan Crisis: Billions More and Additional Reforms Needed,” April 6, 1990, GAO/T-AFMD-90-15.

*Lost tax revenues from Federal Savings & Loan Insurance Corporation transactions.

The working-capital issue raises several important problems. In one sense, the working capital is deficit-neutral over the long haul, because money borrowed will be repaid eventually when the assets are sold. However, in the short run, the working-capital cash flow would have created severe distortions in the budget process—and especially in the Gramm-Rudman process. In the early years, the borrowing will swell the deficit, because RTC’s costs are counted on the federal budget. Then, in later years when the RTC sold the assets, the proceeds would greatly reduce the deficit. In March 1990, for example, the Congressional Budget Office estimated that RTC costs would increase the deficit for FY 1991 by \$31 billion and put the \$64 billion Gramm-Rudman target even further out of reach.¹¹ In fact, the working capital problem proved to be the catalyst that brought President Bush and Democratic congressional leaders to the budget summit that began in May 1990. And at the summit, a prime item on the agenda was a plan to remove the cost of the RTC’s working capital from Gramm-Rudman calculations. Underlying the high politics of the deficit talks, however, was a deeper issue: the amount of money required to provide the working capital depended on the pace of the bailout, and therefore it created strong pressures on the RTC to sell assets quickly, regardless of other implications.

Oversight

The governing structure for RTC is perhaps the most complex ever created for a government entity. Congress established a five-member Oversight Board to supervise the RTC. The board is composed of the Secretary of the Treasury, who serves as its chairman; the Secretary of Housing and Urban Development (HUD); the chairman of the Board of Governors of the Federal Reserve; and two private citizens with experience in housing issues, appointed by the president and confirmed by the Senate. The Oversight Board is responsible for establishing overall policy for the RTC and for supervising its performance. The Oversight Board, however, does not examine RTC's day-to-day operations or the disposition of particular assets. This is the first government corporation to be overseen by such a board, and it is the first time that an official of the Federal Reserve has had authority over another government organization.

The Oversight Board supervises the FDIC Board of Directors, which in turn manages the FDIC employees who work to liquidate the assets of the troubled thrifts. In practice, then, the FDIC chairman serves as RTC's chairman of the board. He works under the supervision of the heads of the three top federal officials most responsible for housing and financial matters (see fig. 1).

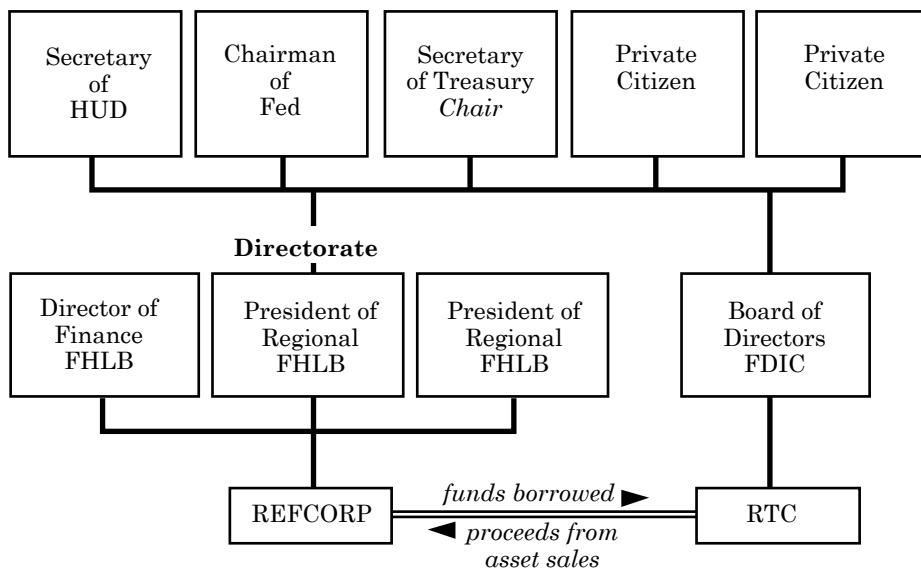
RTC's oversight is so complicated—and conflictual—because it was created to deal with two paradoxes.

The managerial paradox. Both the administration and members of Congress sought to provide RTC with unusual flexibility in its operations. On the other hand, they were determined to keep RTC under careful enough oversight to prevent the financial disasters that occurred in resolutions of troubled thrifts at the end of 1988.

The financial paradox. Following the trail of RTC's finances demands great expertise and ingenuity. Although it was created as an on-budget entity, much of its financing flows through REFCORP, which is off-budget. There is a paradox in using such complicated funding outside the regular budgetary process at the same time the government is struggling to maintain financial accountability for the rescue.

These paradoxes in turn underline the two critical issues of accountability for the RTC: managerial accountability (how the critical decisions governing the sale of assets will be made) and financial accountability (how the enormous flow of capital will be controlled).

Figure 1. Oversight Board



Managerial accountability

The patterns of oversight represented in figure 1 are an organization chart maker’s nightmare. They violate nearly every standard of traditional administration. Organizations are supposed to be established with unity of command—each person and entity has one master—and clear lines of authority—everyone knows to whom he or she must answer. RTC was not so established. The early tangles over just who was in charge, in fact, prompted the RTC Oversight Board’s first head, Daniel P. Kearney, to resign. “After serious reflection,” Kearney said, “I have concluded that the role of president and chief executive officer of the Oversight Board does not currently afford me the authority that I believe is essential to be effective in this process.”¹² Kearney’s problems were wrapped up in the intricacy of competing control of the RTC.

Competing control

The RTC was quite deliberately created to prevent the emergence of a strong manager. The reasons are rooted both in history and in recent bank regulation scandals.

Regulatory rivalries. From the very beginning of government regulation of the banking industry in the 1930s no one has trusted any one government agency with the job of overseeing thrifts and banks. The Federal Reserve and the Treasury, for example, quarreled in 1938 over consolidating bank regulation in the Fed. The Treasury's comptroller of the currency was responsible for national banks, the Fed for state banks that belonged to the Federal Reserve System, and the FDIC for insured banks that did not belong to the Fed. The states regulated the 10 percent of the banks that were not subject to any of these regulators. Franklin D. Roosevelt recognized that he could consolidate bank regulation in one of these agencies only by alienating the others, and he declined to act.¹³ Since then, each regulator has struggled to keep control over its segment of the industry, producing what many critics have called "competition in laxity." Financial institutions often could choose the financial system that would provide the most favorable operating procedures.

Such a contentious past established that neither the Treasury nor the Fed nor the FDIC would be placed in charge of the S&L rescue. The disputes of the 1930s had established a truce among them, a truce founded on an uneasy balance of regulatory authority among these three major regulators that has been carefully maintained ever since.

U.S. Department of Housing and Urban Development scandals. The U.S. Department of Housing and Urban Development (HUD) was another potential candidate for overseeing the rescue. After news reports of influence peddling within HUD during the Reagan administration, members of Congress were not about to trust HUD officials with overseeing the \$100-billion-plus rescue. The report, in particular, that former Secretary of the Interior James G. Watt received \$300,000 for making a few telephone calls for a federally assisted housing project in Essex, Maryland, galvanized suspicion about HUD.¹⁴ Given the role that housing finance played in the S&L crisis, it was inevitable that the department would play an important role in the rescue. However, given the 1989 scandal, it was also inevitable that HUD would play a minor role at most.

Federal Home Loan Bank Board. It was even less likely that the FHLBB would be trusted with the administration of the rescue plan. The GAO launched several investigations of the 75 transactions (involving 179 thrifts) conducted by the FHLBB in December 1988. The purchasers of the thrifts realized tax benefits of between \$7 billion and \$8 billion, but the rapid sell-off drove up the government's costs and worsened the FSLIC's financial position. Moreover, GAO worried whether FSLIC had "the resources for the

extensive monitoring that these complex deals require.” The new thrifts were thinly capitalized and the FHLBB inconsistently managed the sell-off.¹⁵ The sale of thrifts in Texas was especially problematic.¹⁶ Given FHLBB’s central role in regulating the thrift industry, it was inevitable that it would play a role, but what was often described as the December 1988 “fire sale” predestined the bank board to play only a minor role in the rescue.

The Oversight Board and accountability

This alphabet soup of regulators produced many agencies with large stakes in the rescue and many possible candidates for overseeing it. Historic rivalries and more recent scandals, however, made it impossible for any one agency to be given the lead responsibility in directing the rescue. Congress and the administration, as a result, included all of the key agencies in the RTC’s complex oversight structure. Their goal was not so much efficient management control and strategic planning as it was a careful balance among competing interests. With the financial stakes so large, the potential for fraud so great, and the evidence of past scandals so strong, Congress created an oversight structure designed to prevent the possibility that any player could gain an advantage.

The result for RTC’s management, however, was confusion in both oversight and day-to-day management. As one House staff member who helped draft the law explained, “When the bill came out, it was like musical chairs. All of a sudden, the music stopped, and the regulators were running around wondering what their turf was, and disagreeing about who could interpret what requirement.”¹⁷ In RTC’s early operations, moreover, there was considerable confusion over who had the last word on its decisions. The Oversight Board, for example, blocked several end-of-FY 1989 transactions. The FDIC was trying to push the sales through quickly to spend down the RTC’s initial \$20 billion capitalization for FY 1989 and to increase its working capital. Treasury officials, in particular, worried that the sales were rushed and would create a bad precedent for RTC’s future operations.

The oversight structure is one no manager would want. As Edward L. Yingling, executive director for government relations at the American Bankers Association, pointed out, “There is potential for being under such political scrutiny that you just get yourself so tied up that you can’t act. Walking that fine line is going to be very, very difficult. Being the RTC may be the toughest job in the country right now.”¹⁸ Indeed, the potential for conflict, especially between

the Treasury (as primary overseer of the RTC and the location for the Oversight Board's staff) and the FDIC (as manager of the RTC), is significant and likely to be lasting.

If the RTC's structure for managerial accountability is a nightmare, it is so because the thrift crisis itself is so serious. It would be unreasonable to expect that any operation so complex and uncertain to occur easily. It would also be unreasonable to expect any rescue that potentially exposes the federal government to liabilities in the hundreds of billions of dollars to proceed without multiple levels of protection. The RTC will be operating in a goldfish bowl, but given the dimensions of the problem, how could it be otherwise?

As the bailout geared up, it became clear that treasury officials were first among equals on the Oversight Board. Top treasury officials set the basic policies for both the board and the RTC, and treasury administrators filled most of the key staff positions on the board. The reasons were clear. The major players on the board saw the bailout as the administration's show, and the Treasury was the logical place from which to launch major strategies, especially after years of major scandals in HUD. The attenuated organizational structure provided a way for the administration to exercise as much control as it wished without having its fingerprints directly on the results. As the bailout progressed, moreover, with the basic policies set, the Oversight Board became more of a staff and oversight agency, with operating responsibilities left to the RTC.

The RTC's job is thus as much political as managerial. "If I had my druthers, it wouldn't be set up that way," RTC chief executive David C. Cooke explained. "But I knew that coming in. I knew that if I could somehow keep all of the various people that I report to reasonably happy, I probably am not going to get into too much hot water with Congress."¹⁹ William Taylor, acting president and chief executive officer of the Oversight Board until May 1990, added, "As a taxpayer, I'd want some oversight. I don't defend this exact structure, but I'd want some oversight."²⁰

In these statements is the keystone of the RTC's managerial accountability. Because no one trusted the RTC to have just one boss, Congress created many, and the RTC's staff will have to struggle to accommodate them, especially the Treasury, because the secretary of the Treasury is chair of the Oversight Board and supervisor of the board's staff. Congress, however, is the RTC's ultimate overseer. So long as Congress itself is satisfied that the rescue is pro-

ceeding effectively, disputes among members of the Oversight Board will loom less important.

The structure was much disparaged in the bailout's first months. Critics argued that a clearer organizational framework could have begun resolving the problem much more quickly. They underestimated, however, just how large a job it was, for RTC was attempting to do nothing less than build—from scratch, under heavy pressure, and in a very short time—the largest real estate agency in the world. In doing its job, the RTC had to satisfy members of Congress, of the administration, and of the general public that the job would be done without the scandals that plagued the thrift industry during the 1980s. Maintaining the legitimacy of the effort was as important as minimizing its costs. The tangled organizational framework was part of the implicit cost of maintaining that legitimacy.

Organizational implications

The RTC faced three difficult issues in launching its operations. First, the law requires that RTC pursue multiple and conflicting goals. Second, the law requires that RTC use the private sector where possible, yet maintain adequate governmental control. Finally, the law establishes a field structure for managing the resolutions but mandates that both RTC and the Oversight Board keep control over the operations. Each of these issues has important organizational implications.

Multiple goals. Within the act are five separate goals that Congress intends the RTC to pursue simultaneously: to maximize the return from the sale of troubled thrifts; to minimize the impact of these transactions on local real estate and financial markets; to make efficient use of the funds obtained from REFCORP and the Treasury; to minimize any losses from the transactions; and to maximize the availability and affordability of homes for low- and moderate-income individuals.

How can RTC structure itself to accomplish the low- and moderate-income housing goal? There are at least two alternatives. One is to establish a subunit within one of RTC's divisions to study and measure how the asset sales affect low- and moderate-income persons. Another is to create a separate unit of equal status with other RTC units. The choice among these alternatives matters,

both managerially and symbolically. If the organizational unit vested with the responsibility for ensuring affordable housing has the same status and rank as units pursuing the act's other goals, the low- and moderate-income housing goal will receive equal attention. Simply put, organization matters, and equality in organizational structure promotes equal attention to parallel goals.

Public versus private. In the legislation, Congress signaled clearly that it expected private contractors to do much of the RTC's work:

In carrying out the Corporation's duties under this section, the Corporation and the Federal Deposit Insurance Corporation shall utilize the services of private persons, including real estate and loan portfolio asset management, property management, auction marketing, and brokerage services, if such services are available in the private sector and the Corporation determines utilization of such services are practicable and efficient.²¹

The work will be complicated and varied. The RTC, for example, will need to sell the thrifts' assets; consequently, the corporation will be relying heavily on real estate agents and auctioneers to market the properties. A major dilemma, in fact, is that the RTC will inevitably need to rely heavily on many of the assessors whose property valuations helped fuel the boom-bust cycle of the thrifts in the 1980s. Furthermore, because the RTC will undoubtedly be unable to sell all the assets immediately, it will have to rely on managers to maintain the properties and, if there are tenants, to continue collecting rents. The RTC will also need agents to service the loans of properties until the loans can be sold. Finally, the act requires RTC to review FSLIC decisions since early 1988, and contractors will undoubtedly play an important role in that study.

This heavy reliance on contractors creates enormous temptations, and Congress is determined to ensure "that such persons act for the public good rather than for personal gain."²² The important role of the contractors raise several important issues. First, the RTC will have to establish careful procedures to ensure that the contractors are selected fairly. The HUD scandal illustrated the dangers of influence peddling, and Congress is determined to avoid a repeat of such sensational events. RTC will have to write careful rules on how its contracts will be let. Second, RTC will have to ensure that minority contractors are adequately represented in its operations.

Third, the act establishes tough conflict-of-interest standards for contractors. In addition to existing federal legislation on contractors' behavior, the act also prohibits a contractor from obtaining an interest in, or advising others about, any thrift on which the contractor has provided some service for RTC. RTC will have to establish a thorough reporting system to track its contractors and their employees.

Finally and most important, RTC will have to create a mechanism for overseeing the contractors' performance. This problem will be substantial, with FDIC's staff squeezed between managing RTC's functions and maintaining its own supervision of the banking industry, which itself has potentially serious problems. One temptation might well be to contract out the job of contract management and supervision. Indeed, the FSLIC in the past contracted out receiverships. It will be very difficult, however, for RTC to ensure adequate accountability of the contractors to federal goals if contract supervision is not under the direct and careful control of federal government officials.

Contract management in domestic agencies suffers from nearly universal problems, as the GAO discovered. Among the difficulties that GAO uncovered were deficiencies in planning the contractors' work and in writing the contracts; the use of cost-plus or cost-plus-fixed-fee contracts, which provided few incentives for good work; contracts issued before agencies were ready for work to begin; and inadequate supervision or unauthorized changes by government workers in contracts. GAO's recommendations on improving civilian agency contracts provide a starting point for RTC's own contracting process.²³ In the end, the initial battles over how the bailout ought to be organized may well prove much less important than how effectively the RTC oversees the operation of private contractors who will perform most of the actual work.

Centralization versus decentralization. Finally, the act anticipated that much of the RTC's activity would be accomplished in the field. The act requires the Oversight Board to establish national and regional advisory boards to advise on asset disposition. The very size of the task, moreover, would never allow it to be accomplished solely from Washington. RTC thus began evolving a four-level organization: a headquarters staff in Washington, regional offices located in key areas of the country, consolidated site offices, and offices to deal with individual institutions.

This structure is inevitably problematic. For example, the regional advisory boards might understandably urge caution in selling assets so as not to disrupt local markets and, incidentally, to transfer the costs of the resolutions to the federal government. Such pressure might lead RTC to try to guess when to try to sell real estate, and such speculation could easily produce even bigger problems. On the other hand, pressure from the boards to resolve the problems quickly could lead to dumping of assets onto local markets, which could depress those markets further. There is a large and potentially serious gap between the incentives of the regions of the country most affected by the crisis and the federal government's goals in resolving the crisis.

Added to these issues is the eternal field-versus-headquarters universe of problems. The field staff could easily become swept up into local concerns and minimize national goals. The headquarters staff most certainly will have a difficult time supervising the field staff's activities. In short, both field and headquarters offices will have significant problems of communication: communicating down what goals and priorities to pursue; and communicating up what the results are. Effective management of RTC's operations depends critically on developing an effective management reporting system.

Financial accountability

The financial issues are far more complex, for the following reasons: the RTC's financial operations are less clearly spelled out in the legislation; the full financial costs of the rescue are unclear; no one has ever tried to dispose of so many distressed assets so quickly; in the context of the Gramm-Rudman budget-balancing battles no one wants to visit these uncertainties on the contentious budgetary process; and the management issues breed important financial accountability problems.

Macro-level issues

The legislation created several layers of fiscal accountability. Congress requires the Oversight Board to set RTC's strategic plans and mandates that RTC report annually to Congress. GAO, moreover, has full authority to audit RTC activities. Macro-level review of RTC's finances will have to occur principally through such prospective planning and retrospective reporting procedures, because the

corporation's financing is relatively insulated from Congress's regular budgetary process. The keys to financial control at this level thus lie in the hands of a relatively small number of experts in GAO, OMB, the Oversight Board, and the relevant congressional committees. Congress as a whole will have to wrestle with both the working capital issue and the possible need for an even larger bailout. Financial oversight of RTC's operations, however, will be a very specialized process that will demand extra vigilance on the part of the overseers.

Micro-level issues

Lower level review of RTC's financial operations will be equally specialized. The problems are complex. RTC must ensure that the assets of the troubled thrifts are appraised fairly. It must ensure that income received from resolution of the assets is accounted for properly. It must ensure that the receipts make their way to Washington. All of these tasks will require a high-quality accounting system and careful audit of financial transactions.

The critical players in micro-level financial accountability are the Oversight Board, through its review of RTC's financial activities, and the RTC's office of inspector general, through its independent investigation of transactions. The Oversight Board's leadership will establish the tone for RTC's activities, and both the quality and the detail of its review will shape how individuals throughout the corporation (and among its contractors) behave. And if being the RTC is the toughest job in the country right now, as one expert observed, being the RTC's inspector general might well be the toughest job within the corporation. More than any other office, the work of RTC's inspector general will determine the corporation's financial integrity. A strong inspector general's office is the sine qua non of RTC's effectiveness.

Summary

The RTC is, by any measure, one of the most complex governmental institutions ever created. Buried within its operations are important questions for its accountability. Careful oversight is required to ensure that the RTC is well managed and that it achieves its goals of rescuing troubled S&Ls with minimal damage to local economies and the lowest cost to federal taxpayers while ensuring affordable

housing for the poor. The evidence to date, however, is that such enterprises often are not well regulated. The storm that gathered over the financial industry during the 1980s testifies volumes about how difficult it is to manage these problems, how easily corrupted solutions can be, and how tempting it is for elected officials to try to wish them away. RTC's effectiveness hinges in part on how well RTC's unique structure works and in part on how effectively Congress and the president exercise their authority.

The remarkable accountability structure of the RTC is scarcely surprising. The stakes are enormous and the risks are high. Neither Congress nor the president was about to trust the S&L rescue to a privately managed enterprise. Given the contentious history of bank regulation in the United States, it was unthinkable that any one federal agency would be given the job of overseeing the rescue. Finally, given the huge and potentially explosive costs of the rescue, neither Congress nor the president was inclined to swamp what little progress was being made in reducing the deficit by including the rescue plan on the budget. The result of these conditions is a peculiarly pragmatic structure with multiple built-in safeguards. It is a structure that nonetheless dilutes accountability among multiple overseers. It creates the potential for hiding or disguising the rescue's real costs, as well as for slowing the process and, thereby, driving the bailout's costs up.

Recommendations

These circumstances suggest four recommendations.

1. *Recognize that the Oversight Board institutionalizes the traditional conflicts in federal regulation of financial institutions.* Although management analysts might want a clearer line of command, and while RTC's managers would certainly prefer a less awkward oversight structure, the RTC's managerial accountability system is carefully fitted to the history of federal financial regulation and the peculiar features of this case. In fact, after the RTC's first months of operations, managerial accountability settled into a reasonably stable pattern. Members of the Oversight Board have a heavy agenda of issues and are unlikely to intervene in RTC operations unless mistakes by the RTC invite intervention. Moreover, the multiplication of overseers, coupled with intense media interest, makes it unlikely that serious managerial problems or abuses could escape scrutiny. The patterns of managerial oversight thus pragmatically match political and historical realities.

2. Put RTC finances completely on-budget. The RTC's financial accountability structure is far more problematic. Although the purpose of accountability is to detect and correct problems, RTC's structure is in many ways created to disguise its operations and understate its costs, at least to those outside the narrow circle of key players. It is one thing to conduct regular GAO audits, to make regular reports to Congress, to include a financial statement in OMB's budget documents, and to examine the way the \$50 billion in initial capitalization is expended. It is quite another thing for the nation to consider how to proceed if, as seems likely, the rescue operation will require even more money. RTC's finances belong, in honest and open fashion, on the federal budget. That proposal is a leading solution to the problem that Seidman and Gilmour identify in mixed-ownership government corporations, such as RTC: "These corporations have at times demanded all of the privileges of a public agency without being willing to accept the responsibilities."²⁴

Although this recommendation may well be politically unfeasible in the highly charged atmosphere of Gramm-Rudman politics and periodic presidential-congressional budget summits, it is undoubtedly true that RTC's peculiar financing structure disguises its costs and dilutes its accountability to the president and the Congress. If the political calculus of elected officials discourages straightforward accountability, the only alternative is even higher levels of vigilance, on everyone's part.

3. Improve congressional capacity for overseeing the RTC. Such vigilance is difficult when, as in the case of the S&L rescue, the phenomenon is complex and the full costs difficult to measure. It is even more difficult when, as has been the case often in the past, Congress pays little attention to the risks such organizations assume or to their financial soundness. If the RTC is to be held accountable, Congress in particular must develop the expertise to ensure that it can ask and understand the answers to the hard questions. Systematic attention to the RTC is the first prerequisite. Congress also should enhance its own expertise, especially through GAO and the Congressional Budget Office, in examining the management and finances of such enterprises.

4. Use government officials to supervise government goals. One of the foremost attractions of the RTC is the budgetary and managerial flexibility its structure allows. Congress further encourages that flexibility by mandating reliance on private contractors wherever possible. It would be tempting to exploit that flexibility even further by relying on private contractors for core functions, including

the supervision of other contractors, preparation of reports to Congress, and financial management. The pressures on FDIC, in fact, might well make that temptation irresistible. The government's experience in other contracted programs, however, demonstrates just how risky that strategy can be. Contracting out for core functions robs the government of the expertise needed to judge the quality of the work it receives and sharply diminishes the level of accountability it can ensure. Core functions should be performed by public officials.

Nowhere is that need more important than in RTC's office of inspector general. This office will have the critical lead responsibility in measuring how the money is spent and ensuring that legislative goals are met. A strong inspector general is the linchpin of RTC's accountability.

Conclusion

The huge size and great risks combined in the strategy to rescue the S&L industry demand that both the Congress and the administration carefully oversee the RTC's operations. The incentives are strong to avoid asking the hard questions, and the issues are so complex that understanding the answers is difficult. The high stakes, however, leave elected officials little choice.

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Endnotes

1. Statement of Charles A. Bowsher, Comptroller General of the United States, "Resolving the Savings and Loan Crisis: Billions More and Additional Reforms Needed." April 6, 1990, GAO/T-AFMD-90-15.
2. *New York Times*, April 12, 1990, A1.
3. Maggie Mahar, "The \$100 Billion Fiasco: Taking the Measure of the Great S&L Bailout," *Barrons*, September 11, 1989, 24. Evidence suggested that S&L delinquencies, however, were spreading into other regions of the country.
4. Public Law 101-73, enacted August 9, 1989.
5. This two-part structure is unusual but not unique. For example, the Federal Savings & Loan Insurance Corporation (FSLIC) Recapitalization Act, passed in 1987, created a Financing Corporation to raise capital in the credit markets. That capital, in turn, was invested in FSLIC stock. The result is similar to the RTC/REFCORP plan approved by Congress in 1989.

On government corporations, see Harold Seidman and Robert Gilmour, *Politics, Position, and Power*, 4th ed. (New York: Oxford University Press, 1986), 281-92; Harold Seidman, "Public Enterprises in the United States," *Annals of Public and Co-operative Economy* (March 1983): 3-18; and Annmarie Hauck Walsh, *The Public's Business: The Politics and Practices of Government Corporations* (Cambridge: MIT Press, 1978).

6. The term of the bonds is not limited by statute. Early plans were to issue 30-year bonds, but in January 1990 REFCORP issued bonds with a 40-year maturity. The bond market's reception of the bonds proved less enthusiastic than bailout officials had hoped.
7. The features of the RTC are contained in Sec. 21A of the Federal Home Loan Bank Act (12 U.S.C. 1421 et seq.) as amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Public Law 101-73), Title V, Sec. 501.
8. Hence the word *resolution* in the Resolution Trust Corporation's name.
9. Bowsher statement, April 6, 1990, 3.
10. U.S. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1991* (Washington: Government Printing Office, 1990), 13. The Justice Department in early 1990 ruled that RTC could borrow funds from the Federal Financing Bank to provide its working capital. *Ibid.*, 193-4.
11. *Ibid.*, Appendix A.
12. *Wall Street Journal*, February 12, 1990, A16.
13. See Donald F. Kettl, *Leadership at the Fed* (New Haven: Yale University Press, 1986), 55-9.

14. *New York Times*, April 29, 1989, A1.
15. Statement by Charles A. Bowsher before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, March 14, 1989, GAO/T-GGD-89-11.
16. U.S. General Accounting Office, *Failed Thrifts: Bank Board's 1988 Texas Resolutions* (Washington: U.S. Government Printing Office, 1989), Report GGD-89-59.
17. Quoted by Margaret E. Kriz, "Hurry-Up Auctioneers," *National Journal*, October 7, 1989, 2460.
18. *Ibid.*, 2458.
19. *Ibid.*, 2460.
20. *National Journal*, May 12, 1990, 1166.
21. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Public Law 101-73, § 501(b)(11)(A)(ii).
22. "Conference Report on H.R. 1278," *Congressional Record*, August 4, 1989, H5284.
23. U.S. General Accounting Office, *Civilian Agency Procurement: Improvements Needed in Contracting and Contract Administration* (Washington: Government Printing Office, September 1989).
24. Seidman and Gilmour, *Politics, Position, and Power*, 291.

