# Amid record losses, Wall Street awarded itself $39 billion

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The five largest Wall Street banks doled out a record $39 billion in bonuses last year, according to data collected by the Bloomberg news service. After driving hundreds of thousands of families into foreclosure, causing a financial crisis affecting hundreds of millions, and pushing the US and world economies closer to recession, it appears Wall Street is rewarding itself for a job well done.

The banks announced record losses in the fourth quarter, wrapping up the financial industry's worst year since 2002. All in all, Wall Street wrote off more than $90 billion in bad debt for the year, and the five largest banks saw their profits drop more than 60 percent. Three of the five firms posted losses in the fourth quarter.

For all that, the bankers made out like bandits. Despite the firms' abysmal performance, Wall Street buffered its traders from any shocks to their incomes by increasing the ratio of compensation relative to revenues. Typically, banks try to keep compensation below 50 percent of revenues; in 2006, when the five firms paid out some $36 billion in year-end bonuses, the figure was approximately 45 percent. In 2007, it jumped to more than 60 percent, according to figures released by the New York State Comptroller's office.

While the $39 billion was divided among 186,000 workers at the five firms—averaging $211,849—the lion's share was reserved for a few thousand high-level managers, traders, and senior executives, who took in multimillion-dollar bonuses in addition to their salaries. Rank-and-file clerical workers took home a few hundred dollars. Bonuses for traders in subprime-related securities are reported to be about 30 percent lower this year in comparison to other sectors.

Morgan Stanley wrote down some $10.3 billion in bad debt in 2007, but increased its bonus pool by 18 percent all the same. Its CEO, John Mack, declined his bonus last year after collecting a $40 million bonus in 2006.

E. Stanley O'Neal, the former chief executive of Merrill Lynch, collected a severance package worth some $161 million, or 3,500 times the yearly income of a typical US household, after losing his job in October. Merrill Lynch wrote down some $20 billion in subprime debt during the fourth quarter of 2007, and saw its value reduced by some 43 percent.

Charles O. Prince II, the former CEO of Citigroup, which announced similar losses, will walk away with some $68 million. Lloyd C. Blankfein, the Goldman Sachs CEO, set a new record with his bonus of $60.7 million. The firm put its chips on different numbers than the other banks and had a good year overall. The firm's two co-presidents, Gary Cohn and Jon Winkelried, each collected a stock bonus of about $40 million, in addition to as-yet undisclosed amounts of cash.

Ike Suri, the managing director of a Finance Executive recruitment firm, told the *Los Angeles Times* that "compensation in the brokerage industry is increasingly tied to volatility—so the more volatility in the markets, the more investors are trading and the more they make." He continued, "The marked increase in volatility in the markets in 2007 really benefited the brokers." Volatility, we might add, which bankers created themselves by gambling—and losing—on risky securities.

The absurdity of this standard is self-evident. But, for all that, no major public figures have called for the leaders of these banks to be held liable for the destruction they caused, much less even called for hearings into their massive pay. Executive compensation, we are told, is a private affair between shareholders and executives, whatever its effect may be on the rest of the population.

Outside the mass media, however, these issues are being hotly debated. In a widely discussed *Financial Times* column dealing with the issue of banker pay, former IMF chief economist Raghuram Rajan writes that executive compensation practices among Wall Street firms "probably contributed to the ongoing crisis" in the financial sector. Rajan goes on to explain the means by which bank managers systematically underpriced and hid risk with the intent of inflating their personal compensation.

Securities trading, according to Rajan, rests on the ability of funds managers to generate returns over and above market expectations, while minimizing overall risk. Rajan notes that differences between a security's real yield and its evaluated growth potential "are quite hard to generate since most ways of doing so depend on the investment manager possessing unique abilities—to pick stocks, identify weaknesses in management and remedy them, or undertake financial innovation. Such abilities are rare. How then can untalented investment managers justify their pay? Unfortunately, all too often it is by creating fake alpha—appearing to create excess returns but in fact taking on hidden tail risks, which produce a steady positive return most of the time as compensation for a rare, very negative, return."

The boom of Collateralized Debt Obligations and other risky mortgage-based securities was probably exacerbated by bankers' attempts to, in Rajan's words, "create fake alpha," that is, to buy securities whose risk was nominally underrated and therefore paid disproportionately high returns. The foreseeable prospect of the real estate market cooling down, resulting in the writing off of billions of dollars of bad debt, massive losses for shareholders, and turmoil in the wider economy, paled alongside the bankers' own grasping for massive amounts of compensation.

For the bank managers themselves, it made perfect sense. Once the racket that they had been running came to light and the securities they bought rendered worthless, the managers would simply lose their jobs, collect millions in compensation, and move on to some other firm. This is exactly what happened at Bear Stearns, Merrill Lynch, Citigroup, and others.

The more farsighted representatives of the establishment recognize—at least in part—the dangers posed by unmitigated greed to the long-term stability of the capitalist system. Martin Wolf, the associate editor of economics at the *Financial Times*, recently wrote in response to Rajan's article: "I now fear that the combination of the fragility of the financial system with the huge rewards it generates for insiders will destroy something even more important—the political legitimacy of the market economy itself—across the globe."

Wolf proposes that the US government step in to regulate banker pay so as to prevent such discrediting spectacles as those seen on Wall Street in 2007. But such action would require an unimaginable sea change in the policies of the US ruling elite, which has sought for the past three decades to break any restrictions on its own blind pillaging of society.

As the Wall Street speculators raked in their bonuses, recent government statistics demonstrate that, for average working people in the US, 2007 spelled a further decline in living standards as consumer prices driven by fuel and food rose sharply and the paltry growth in wages recorded the previous year stalled. Average weekly wages last year fell approximately 1 percent.

The combination of record bonuses for Wall Street's wealthiest and a drop in real wages for hundreds of millions recorded in 2007 is only the latest episode in the protracted process of transferring wealth from masses of working people to a tiny financial elite. The outcome is a level of inequality that is politically and socially unsustainable and which makes open class struggle inevitable. This is what is meant by the destruction of "the political legitimacy of the market economy itself."