US bank losses wipe out years of paper profits

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A milestone was reached Thursday by the US banking system: With the announcement by Citigroup and Merrill Lynch of billions of dollars in additional losses in their third quarter reports, all of the profits accumulated by the nine biggest banks during the three-and-a-half-year housing boom had vanished.

In an article headlined "Banks Are Likely to Hold Tight to Bailout Money," the *New York Times* reported Friday that Citigroup's $13.2 billion in charges and Merrill Lynch's $5.15 billion in write-downs brought the total losses of the major banks since the credit crisis erupted in mid-2007 to $323 billion, surpassing the $305 billion taken in from early 2004 to mid-2007 by Citigroup, Merrill Lynch, Bank of America, Morgan Stanley, JPMorgan Chase, Goldman Sachs, Wells Fargo, Washington Mutual and Wachovia.

"For every dollar the banks earned during the industry's most prosperous years," the *Times* noted, "they have now wiped out $1.06."

Commenting in measured terms on the collapse of what amounts to a gigantic Ponzi scheme perpetrated by the most powerful financial firms, Richard Sylla, an economist and financial historian at the Stern School of Business at New York University, said, "The losses now are showing that in some sense the profits reported in earlier years were not real, because they were taking too much risk then."

This was a reference to the proliferation of exotic and opaque speculative financial instruments—collateralized debt obligations, structured investment vehicles, credit default swaps—that were devised by the wizards of Wall Street to generate super profits based on a mountain of debt backed by virtually no real value. On the basis of these paper values, they rewarded themselves with salaries and bonuses in the tens and hundreds of millions of dollars.

Now, standing in the midst of the ruins of their own firms and the onset of an economic catastrophe for millions of working people in the US and around the world, these very same bankers are declaring that they have no intention any time soon of using the billions in taxpayer money handed them by the government to resume lending and unfreeze the credit markets—the ostensible purpose of the bailout measures whose estimated cost to the American people has risen to $2.25 trillion.

The collapse of the financial house of cards has exposed the ideological nostrums that have been used to defend American capitalism—such as the infallibility of the market and the irreplaceable role of the capitalist "risk-takers," the supposed justification for their stratospheric compensation packages.

The gospel of the "free market," which has, particularly over the past three decades, become the secular religion of the entire political establishment, has proven to be a recipe for social disaster. In one sense, however, the system has worked quite well. It has performed its essential function of generating colossal levels of personal wealth for the financial aristocracy.

The *Financial Times* reported last month that compensation for major executives of the seven largest US banks totaled $95 billion over the past three years, even as the banks recorded $500 billion in losses.

Small shareholders have been ruined; pensions, IRAs and 401(K)s have been decimated, factories are closing and families in the millions are losing their homes—but the Wall Street titans get to keep every penny they have pocketed for themselves.

To give some idea of sums involved, John Thain, the head of Merrill Lynch and, according to the Associated Press, the best-paid CEO, took in $83 million in 2007. His bank averted collapse last month by agreeing to be bought by Bank of America. Merrill's write-downs from mid-2007 through the third quarter of 2008 total close to $55 billion, or 254 percent of the bank's profits from 2004 through the first half of 2007.

Lloyd Blankfein, the CEO of Goldman Sachs (formerly headed by Treasury Secretary Henry Paulson), received $68 million in 2007.

John Mack, the head of Morgan Stanley, received $41.8 million in compensation last year, and his 2007 holdings in Morgan Stanley stock were worth $220 million. Morgan Stanley has written off about $15 billion in bad assets, equal to 70 percent of its boom-time profits.

JPMorgan Chase CEO Jamie Dimon's total 2008 compensation, according to *Forbes* magazine, is $27,797,000. His bank has written off some $23 billion over the past 20 months.

At the height of the profit boom, in December of 2006, Wall Street awarded Christmas bonuses totaling more than $100 billion. This sum was more than twice the annual budget of the US Department of Housing and Urban Development and nearly twice the US Department of Education budget. It was five times what Washington spent on foreign aid to the entire world, and twice the budget of the City of New York, which employed 250,000 people.

The Wall Street bailout has provided a valuable lesson on the nature of class relations in America. It has exposed the subservience of the state, behind the trappings of democracy, to the financial aristocracy.

Paulson had to plead with the top CEOs to agree to his plan to inject $250 billion in public funds into the banks, $125 billion going to the nine largest firms, through a government purchase of stock. They agreed only when he presented the terms of the deal and it became clear how extraordinarily favorable they were—as the *Times* put it, "more favorable than they would have received in the marketplace."

Indeed. The banks will be charged cut-rate fees in return for the cash, there will be no real limits on executive pay, and the government will exercise no control over their operations. There is not even a requirement that the banks use the public money to extend credit to other banks, businesses or individuals.

"The government," the *Times* wrote, "offered no written requirement about how or when the banks must use the money." The newspaper quoted John C. Dugan, the comptroller of the currency, affirming that he "would not examine how the banks use the money."

They could use it to acquire weaker competitors, or just hoard it.

Despite a public plea by Paulson on Monday for the banks to use their government handout to resume lending, the bankers are making no such commitment. Said Merrill's Thain on Thursday, "We will have the opportunity to redeploy that. But at least for the next quarter, it's just going to be a cushion."

Roger Freeman, an analyst at Barclays Capital, said, "My expectation is it's quarters off, not months off, before you see that capital being put to work."

Despite this carte blanche for the bankers, it was deemed necessary to roll out George W. Bush on Friday to reassure Wall Street that there were no strings attached and no hint of nationalization in the bailout scheme. Speaking before the US Chamber of Commerce early Friday morning—his remarks timed to precede the opening of the stock market—Bush paid obeisance to "democratic capitalism" as "the greatest system ever devised."

"Some have viewed this temporary measure as a step toward nationalizing banks," he said. "This is simply not the case."

To dispel all doubts, he specified key terms of the deal: "The government will not exercise control over any private firm. Federal officers will not have a seat around your local bank's boardroom table. The shares owned by the government will have voting rights that can be used only to protect the taxpayers' investment, not to direct the firm's operations.

"The government intervention is not a government takeover. Its purpose is not to weaken the free market; it is to preserve the free market."

He added, "We must not blur the line between the government and the private sector. We must not supplant the profit motive with political motives."

Everyone in the audience understood that "political motives" was a euphemism for infringing on profit and the wealth of the financial elite to address the social crisis facing the working class.