Jeffrey Sachs: Bank Bonuses and the Reform Agenda in the Balance

Health care reform hangs in the balance at the same time we learn from the Cuomo Report that nine banks, all recipients of federal bailout support, paid an astounding $33 billion in bonuses in 2008, including more than 4,700 bonuses of at least $1 million. Though seemingly unrelated, health care reform and the bank bonus scandal are interconnected. When Washington politics seems merely to be a scam, even worthy policy initiatives like health care reform are likely to go down in flames. On the other hand, if Washington would now move aggressively to claw back these ill-gotten bonuses, the public would also place increased trust in Washington to tackle reforms such as health care.

Consider just two of the banks involved in the bonus scandal: Citigroup and Merrill. Together they lost $54 billion in 2008 and received $55 billion in TARP bailout funds. Yet this did not stop them from paying $9 billion in bonuses for a job well done. Merrill’s top four bonus recipients pocketed $121 million, and the next four took home $62 million. Citigroup, propped up from collapse by the U.S. government, paid a shocking 738 employees more than $1 million each.

Everything is wrong with this picture. Even in a good year much of the Wall Street bonus package is merely banking on special privileges from the U.S. government that allow the big banks to gamble to the hilt. In a bad year, like 2007, the Wall Street bonuses are brazen. In 2008, the year that the banks nearly brought the global financial system to a halt, the $33 billion are without a shred of legitimacy.

Perhaps $3.7 billion explains why all too many in Washington seem ready to allow the abuses to stand. According to opensecrets.org, that’s the amount that the financial sector paid in lobbying during 1999-2008. This was the largest lobbying outlay of any sector of the economy. Perhaps $474 million adds to the explanation. That’s the amount of campaign contributions by the financial sector (both individuals and PACs) during the 2008 electoral cycle, again the most by any sector.

This largesse produced the deregulation of the late 1990s that allowed the bonuses to soar on the mirage of unregulated credit default swaps. That’s the same deregulation that eventually led to the trillions of dollars of asset losses now being picked up by Americans and other taxpayers around the world. And of course that’s the deregulation that has made possible the soaring compensation in the financial sector, a point demonstrated convincingly in a recent scholarly paper by Philippon and Reshef.

What is needed now? First, we need government action to claw back the ill-gotten 2008 bonuses. All nine of the banks covered in the Cuomo Report received TARP funding. All have depended on government largesse in other ways as well, including transfers from AIG, itself bailed out by the government, and cheap loans from the Fed. A recent Financial Times story explained that this year’s Wall Street profits are also padded by what is essentially insider trading with the Fed in the market for U.S. Treasuries. As Paul Krugman has rightly emphasized in his recent New York Times columns, the banks’ wins have been our losses. Even if the banks are making profits again, they have polluted the world’s financial system with trillions of dollars of losses incurred by the rest of society, and owe the renewed profits significantly to taxpayer largesse.
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First, let’s recall (if we need reminding!) that $33 billion is a rather meaningful sum to pay out to some thousands of people. After all, in a world of extraordinary hunger and suffering, all of the rich world combined recently promised a total of $20 billion over three years to relieve the plight of hundreds of millions of people in the world’s hungriest farm households. Yet here is $33 billion in a single year for some thousands of bankers in nine banks during a catastrophic year. The $33 billion per year, or $330 billion over a decade, would also pay for roughly one third of the extension of health insurance to the 46 million or so uninsured Americans. In short, we will suffer a huge lost opportunity, as well as a blow to social justice, if Washington simply winks cynically at the «finality» of these unjustified bonuses.

Second, let us reject the view that bank compensation is in any event a matter to be left solely to the banks’ shareholders and management. As Prof. Lucian Bebchuk of Harvard Law School has rightly emphasized in the Financial Times and elsewhere, even if bank shareholders were to gain a better control over management compensation than they have now, the shareholders and managers actually would still share the incentive to gamble recklessly in view of the government guarantees and expected future bailouts. Bank shareholders will not adopt bonus schedules that protect the public from the excessive risk-taking of the banks. Only bank regulators can do that.

President Obama promised real change in Washington so that our country can escape from the poison of insider interests and unprecedented inequalities in wealth and influence. His agenda for change has the public’s support, enough to win the 2008 election and re-election in 2012 if the reforms are adopted and implemented. It would be tragic to squander this chance for change by Washington remaining passive as the banks flagrantly abuse the taxpayers’ trust and hard-earned income.