AlterNet

How the Wall Street Mafia Holds America -- and the World -- Hostage

Matt Taibbi and Yves Smith, June 25, 2012

Rolling Stone editor Matt Taibbi and Yves Smith, creator of the finance and economics blog Naked Capitalism, join Bill to discuss the folly and corruption of both banks and government, and how that tag-team leaves deep wounds in our democracy. Taibbi's latest piece is "The Scam Wall Street Learned from the Mafia." Smith is the author of "ECONned: How Unenlightened Self Interest Undermined Democracy and Corrupted Capitalism."

Bill Moyers: Welcome. This past week, Jamie Dimon, CEO of JP Morgan Chase, was back on Capitol Hill, testifying before the House Financial Services Committee, as he had earlier done before the Senate Banking Committee. He was being questioned on how his bank had lost two billion dollars -- or more -- on risky trading. His reception in the House was less fawning than what he got from the senators. Although many of them also are beneficiaries of JP Morgan largesse, House members were more combative.

Barney Frank: You said you have a fortress balance sheet. That assumes there's something special about the way you are that made us have to worry less. But we can't assume that's going to be the case for every financial institution.

Jamie Dimon: But I also said that we'd be solidly profitable this quarter. So relative to earnings–

Barney Frank: That's not the question. Mr. Dimon, please don't filibuster.

Sean Duffy: You didn't know about these trades. You didn't know about these losses. How do you come forward today and say the regulators should have known that -- what one of the best CEOs in the industry didn't know and couldn't have known?

Michael Capuano: With the regulatory regime that we have today -- we both agree that it's not what we want, but it's what we have. Do you really think it's a smart idea to be cutting the legs out of one of those major regulators? Do you think that's good for America?

Jamie Dimon: I have enough problems. I'm going to leave that to you.

Michael Capuano: Well, Mr. Dimon, the only reason I ask is because you have had no hesitancy whatsoever in expressing opinions on other matters. I thought you might want to take an opportunity to express one today.

Bill Moyers: Coincidentally, just before Dimon's House testimony, Bloomberg News published data indicating that JP Morgan Chase receives a government subsidy worth about 14 billion dollars a year in taxpayer money.

Money, said Bloomberg editors, that "helps the bank pay big salaries and bonuses, and more important, distorts markets, fueling crises such as the recent subprime-lending disaster and the sovereign-debt debacle that is now threatening to destroy the euro and sink the global economy."

With me are two guests who can guide us through the thicket of testimony and beyond. Matt Taibbi, contributing editor at "Rolling Stone" magazine, has investigated the folly and corruption of banks and government with scathing, often profane wit and perception. His book, Griftopia: Bubble Machines, Vampire Squids, and the Long Con That Is Breaking America, described the events leading up to the financial meltdown in 2008. His newest piece for Rolling Stone is a chilling expose called "The Scam Wall Street Learned From the Mafia."

Yves Smith created and runs Naked Capitalism, the popular blog on finance and economics. She once worked for Goldman Sachs, McKinsey & Company, and Sumitomo Bank, and now heads a management consulting firm. You'll want to read her book, ECONned: How Unenlightened Self Interest Undermined Democracy and Corrupted Capitalism.

Welcome to both of you.

Yves Smith: Thanks so much.

Matt Taibbi: Thank you.

Bill Moyers: So in this particular case, what is JPMorgan's sin? That's the question Representative David Schweikert raised on the day of the hearing. He asked, "What sin has JPMorgan committed other than being big enough to lose billions of their own money in a quarter and still turn a $4 billion profit?" Want to take a stab at answering?

Matt Taibbi: Yeah, sure. Their sin wasn't the loss. The sin was in being a too-big-to-fail company where we can't afford to have them go under. Why are we there in the first place? If this was a company that, if it went out of business, it wouldn't affect our lives personally and wouldn't have major ramification for the economy, we wouldn't be holding hearings in the Senate and the Congress.

We would say, fine, they lost so much, a bunch of money. Too bad for them. But that's not the case. As we saw in 2008, when these companies go down, we all end up paying for it. You know, we ended up financing of, what, five, six, seven trillion dollar bailout in 2008. And if a company like JPMorgan Chase goes under, there will certainly be some sort of federal action, which is why we have to know about it. We have to know what goes on when they have unexpected two, three billion dollar losses that affects all of us.

Yves Smith: They were guilty of gaming the system. And the way that they've done it is this unit was using depositor money and yet taking very large bets.

And in this unit, all the other banks similarly have similar units in their treasury department, and the purpose of these portfolios is supposed to be to have liquid assets in case there's a run on the bank.

And Bloomberg News had a story where they actually reported that all the other banks take less risk in these portfolios. And that's before we get to the credit default-- that's before we get to the blow-up part, just in the, even the simpler part of the portfolios. They have, they keep more in treasuries. And they have less in corporate bonds. So Dimon is already taking more risk in this unit than he should have.

And this is something which is frustrating about the testimony. There's a sort of, you know, one of the, again, stories that Dimon was promoting was, oh, well, we didn't find out about it. And then when we found out about it, we jumped on it and now it's all fine. And, therefore, the regulators shouldn't have been able, you know, how could the regulators have found about it?

And, therefore, since the regulators couldn't found out, you know, more regulation is futile. And, in fact, you could have found this information from the outside. You could have seen that prices were moving in this instrument in a really weird way.

Bill Moyers: Was everybody looking the other way? Have we forgotten so quickly?

Matt Taibbi: Well, the entire derivatives market is essentially a gigantic black box. It's not like the regulators have access to all this information.

Yves Smith: I think they're not used to looking for the information.

Matt Taibbi: Right.

Yves Smith: I think it's been acculturated that they're used to having tea and cookies with the banks and reviewing their internal reports and not doing any type of external validation and this kind of basic external checking they could do that they're not habituated to doing.

Bill Moyers: A very curious thing happened when the House hearings opened. Some members of that committee felt that Dimon should be sworn in. But the chairman of the committee, a Republican from Alabama, Spencer Bachus, said, no, that wasn't necessary. Am I making too much out of that?

Matt Taibbi: I thought that was an incredible moment for a couple of reasons. Obviously, the reason there was a hullabaloo over that was because of what happened when Lloyd Blankfein, the CEO of Goldman Sachs, came and testified before the Senate a couple of years ago. There later was a controversy over whether or not he had perjured himself in those hearings.

So the question was if, you know, Jamie Dimon is going to be sworn in, whether he would have to tell the truth, would be obligated, or whether it would just be a friendly conversation. But what was amazing about that, was that it Spencer Bachus who came to Jamie Dimon's defense. Spencer Bachus is the congressman for the Birmingham, Alabama, region which has been decimated by the Jefferson County swap disaster, which was caused by Chase, which was fined $700 million by the SEC.

So here's a guy who represents the county that has been most affected by Chase's bad behavior, and he comes to Chase's defense in the hearing, which I thought was-- it set the tone for the whole thing.

Yves Smith: Matt mentioned the toxic swaps. Jefferson County isn't the only example.

There have been a whole series of, you know, since Jefferson County and other municipalities blew up by deals they did before the crisis, there have been a series of swaps done after the crisis with transit authorities, where they are losing a tremendous amount of money. You can look at the way JPMorgan has serviced mortgage loans.

You know, they had to get up and admit that they had been basically breaking the law, and there were criminal penalties associated with this law, by foreclosing on servicemen in Iraq and not giving them rate breaks that they were entitled to. And there are some egregious cases.

Matt Taibbi: There's $228 million fine that they paid last year for municipal bond bid rigging. There was another $153 million fine that they paid for failure to, for fraud in CDO trades. I mean, there are case after case after case that involve these criminal charges. And what I thought was amazing about these hearings is that nobody brought any of those things up.

Bill Moyers: Both of you have mentioned the Jefferson County story. Give me a quick summary of what JPMorgan did in Jefferson County, Alabama.

Matt Taibbi: Well, Jefferson County had to build a new sewer system. And they had to borrow a bunch of money to do that. And it was originally a $300 million project. But they got into a series of swap deals with JPMorgan Chase to basically push their financing into the future. But the deals were heavily mispriced in Chase's favor. And Chase actually bribed another bank to stay away from Chase because they wanted that business. They wanted to give the--

Bill Moyers: Bribed them?

Matt Taibbi: They bribed them.

Bill Moyers: That's against the law, isn't it?

Matt Taibbi: Yes, yes.

Yves Smith: Yeah.

Matt Taibbi: And they were caught for it. A couple of their executives were caught for it, and they were heavily fined by the SEC for doing it. And this resulted in this disaster where Jefferson County's going to be bankrupt for a generation. It ended up costing them $3 billion out of what was originally, what, $300 million?

Yves Smith: Million dollar, yeah, yeah, yeah. What got to be $2.9 billion deal in the end. And on top of that, my mother happens to live in Jefferson County.

Bill Moyers: Oh, I didn't know that.

Yves Smith: You have the average person in-- basically you cannot have access to the sewage system and not pay more than-- and not pay less than 50 bucks a month. So there are people in the poor areas who are deciding what they're going to have: electricity, water, or sewer. I mean, you can't-- they can't afford all three.

Bill Moyers: Why is that JPMorgan's fault that they have to make that choice?

Matt Taibbi: They basically got them into these onerous toxic swap deals that were poorly understood by the local politicians. And they bribed the local politicians to accept the swap deals. They did it through middleman companies that bribed the--

Yves Smith: The consultant on the deal is in jail. The former mayor was involved in other improprieties, too. But the former mayor's in prison. You know, this is--

Matt Taibbi: For signing off on these deals.

Bill Moyers: Is there a question you would have asked Dimon if you had been on either of those committees that was not asked?

Matt Taibbi: The question I wanted to ask is, was, really more about the criminality. I mean, none of the members in either the House or the Senate really got into the issue of all the different offenses that these banks have committed in the last few years. You know, or, an ordinary person, if he commits welfare fraud, never gets a food stamp again in his life.

So given that these banks have systematically and repeatedly committed fraud, repeatedly been caught, you know, in situations like Jefferson County, municipal bid rigging, why should we still give them billions and billions of dollars in emergency lending from the Fed, bailouts, all of this aid from the government? How come there's no consequences for them and there are consequences for ordinary people?

Yves Smith: I would have asked questions more having to do with what's the justification for complex banking at all? That why do we need, why shouldn't banks be run on the utility basis? Why should we have people like Dimon and his, the members of the CIO unit, most of which he's fired, what the justification for literally that hundreds of millions of bonuses were paid collectively to those people.

And now he says they didn't know what they were doing. There's no justification for this, the sort of level of compensation that we generally have on Wall Street. And I would like to see that myth starting to be punctured in more public places.

Bill Moyers: What do you mean when you say banks should be more like a utility?

Yves Smith: Banks, more than any other business, more than military contractors, live off the government. They depend on government backstopping. They exist only by way of government issued licenses, which if you had open entry you'd see much lower fees. And they get some confidence from the public from the fact that they are regulated. Oh, and the most important thing is they have access to--

Matt Taibbi: The Federal Reserve.

Yves Smith: --the Federal Reserve.

Matt Taibbi: They're getting huge amounts of free money.

Yves Smith: Well, not just the free money. The Federal Reserve basically guarantees the payment system. You know, that's the really critical architecture that banks control is that, you know, we write checks to each other. We have credit cards. They clear through banks.

But the fact that banks can exchange money with each other confidently is because the Fed stands behind that. So there's a much-- there's another layer of Fed backstopping beyond what we think of the way they step in in a crisis or the way they're now intervening to help the banks. So the fact that these institution really depend in a very fundamental way on government support means they don't have any right to the upside.

I mean, they should really be paid like public servants. I mean, I'm not kidding. I mean, and if they had been, if the pay had been ratcheted down after the crisis, I would have had a lot more sympathy for them, even if they just behaved for a couple of years. You know, they were bailed out. And then in 2009 the industry went and paid itself record bonuses, higher than 2007 instead of rebuilding their balance sheets. I mean, this was just a slap in the face for the public.

Bill Moyers: And there's no shame.

Yves Smith: No.

Bill Moyers: You're describing a corrupt financial and political system. And both of you in recent writings, your current article in "Rolling Stone," which is devastating on the scam that the "Wall Street learned from the Mafia," and a recent column you wrote about the mafia state, you're both using that metaphor to apply to our financial and political system. When I read your pieces, you're not playing with words there. You mean it.

Yves Smith: Yeah.

Bill Moyers: Why do you mean it?

Yves Smith: Well, the mafia, when it gets to be big enough, first thing it has services that people feel they need if they're in a difficult situation. So, for example, loan sharking. If you really need money, they do have the money. And people enter into these loan shark deals even though they know it's going to be very difficult to pay 20 percent or more interest and they'll have their legs broken if they don't pay back.

And the banks actually behave very much in that manner when they find people who really need money. So you see this with credit cards, you know, that, or, and with mortgages. That if you hit-- it's not this if you hit any tripwire, that, you know, become in arrears, the banks basically act in this very extortionate manner and don't cut any breaks.

Matt Taibbi: And I think that there's also this, they are the mafia because of their vast criminality in Wall Street now is that it's bribery, theft, fraud, bid rigging, price fixing, gambling, loan sharking. All of these things, it's all organized.

I mean, the story I just wrote about, which was about the systematic rigging of municipal bond auctions, which affected every community in every state in the country and all of the major banks were involved, including Chase.

They were rigging the auctions that were designed to create a fair rate of return on the investments that towns were getting on their-- the money they borrowed for municipal bonds. And this is not like something that the mafia does. This is what the mafia does. The mafia has historically, it's one of their staple businesses, is bid rigging for construction or garbage or, you know, street cleaning services, whatever it is.

They're doing exactly the same thing. The only thing that's different is there's no violence involved. But what their method of control is that they're ubiquitous. They have this incredible political power that the mafia never had.

Yves Smith: And they also have what amounts to an oligopoly. I mean, for many of these services, you have a great deal of difficulty going beyond the five biggest banks, you know? This is-- it's the consequence of too big to fail is that when, you know, some of the smaller players, again, you know, like-- JPMorgan buying Bear Stearns.

In the crisis, when the smaller players got sick, they were merged into the bigger players. So now if you want-- for a lot of these services, there aren't that many players for you to go to. You really have no choice in-- other than to deal with the big banks.

Bill Moyers: Congress is paid to be informed and to hold these guys accountable. Why don't they ask the kind of questions you're dealing with here?

Matt Taibbi: People refuse to look at these banks and think of them as organized crime organizations.

They in their eyes, organized crime is always either the Italian mafia or the Irish mafia. This isn't what it looks like. But that is who they are. And I think that they're treated with a kind of deference and respect, because traditionally that's not who they were. They were these icons of finance who helped build this country.

But that's not who they are anymore. And I think, it's hard for people to wrap their heads around that and treat them the way they should be treated.

Yves Smith: Well, I think people don't want to think that there's something wrong with leaders. And CEOs are leaders of the business community. If you really believe that CEOs of businesses that are really fundamental to the economy are corrupt, you have to think of a very serious restructuring of the business and financial system.

And even if people kind of intellectually might be willing to contemplate that, they don't really want to go to what the implications are. So it's much easier for them to block out that thought.

Bill Moyers: Both of you have been writing a great deal lately about the crisis in Europe. So explain to us simply what hand Wall Street has in what's going on in Italy, Greece, and Spain today and why we should care.

Yves Smith: Well, I almost want to go one step of abstraction higher because people tend to focus on the immediate ways Wall Street was involved like Goldman Sachs helped Greece cover up how serious its deficits were.

Matt Taibbi: Which in the situation, it was very similar to Jefferson County, by the way.

Yves Smith: Right. But the more important story is much higher, which is that the reason the big reason that all, you have basically a sovereign debt crisis, that the governments in Europe, many of them had to borrow a tremendous amount of money in the wake of the crisis. And the euro zone is not well set up to adapt to that. I could go into technical reasons why, but it's not unlike a state.

You know, when a state has a budget problem that suddenly they have to think about, you know, cutting costs and doing all kinds of draconian measures. And while maybe a state or a city can do that, you can't have the biggest economy in the world. I mean, Europe is the biggest economy in the world doing that and not have it basically turn into a down spiral, that you cut spending and then that leads to less income.

And your deficits get worse rather than better. So, but the reason they had that problem is, in fact, very directly the result of the financial crisis. That you had countries that weren't running deficits, government deficits like Ireland and Spain, that were held up as poster children before the crisis of doing things right.

And that when the crisis hit, you both had a big drop in tax revenues. You had bank bailouts. And these countries had decent social safety nets so that, you know, things like, you know, unemployment insurance went up. And so the budget crisis they're having is the direct result of the financial crisis. And yet it's somehow being treated as if they're separate events. Like somehow these governments were profligate and that borrowers were irresponsible –

Matt Taibbi: Social safety net.

Yves Smith: Safety net.

Matt Taibbi: Exactly. Right. That's clearly going to be the place that is going to take the brunt of the damage. I mean, I think the most direct example here in America was a lot of unions and state pension funds were primary victims of the sort of broad fraud scheme to sell fraudulent mortgage backed securities.

So they, a lot of these institutional investors were buying these bad mortgages, huge pools of mortgages from all these, the usual suspects, the big banks. And then when they decreased in value and suddenly there they don't have, it's harder for them to meet their obligation and suddenly the finger is pointed at them and everyone saying, "Oh, look at those pens, the state pensioners or look at those union employees, they're they cost too much money. We have to cut their services. We have to cut pensions. We have to do all these things."

Whereas, in fact, they were buying a fraudulent product from Wall Street and that's why they're in such bad shape now. And I think, but politically, the direction is always going to be let's blame-

Bill Moyers: The poor.

Matt Taibbi: That person. The poor.

Bill Moyers: The guy on the pension. The woman on the pension –

Matt Taibbi: Right. And we'll never point the finger in the other direction.

Yves Smith: Well, in fact, the implications, that's true. But the implications are actually quite grim, and they're not being discussed honestly. We're talking about old people dying faster. We're talking about children being homeless and not getting education, and we're talking about grim outcomes like that.

And they're not even part of the discourse. I mean, you look, Greece is the extreme example. But in Greece, the hospitals are breaking down. Garbage is not being picked up. And if you look at the results of the last election, what you saw is even with the efforts to scare people into staying in the euro, you see this polarization where the Nazi Party got seven percent of the vote even after there was an incident in a TV station where there was literally an on-air fight where a Nazi Party member beat up on somebody basically I think it was on camera, you know?

So you've got a real social polarization with radicalization going on. And I've seen a number of reports out of Greece saying that it's basically on knife edge of breakdown.

Bill Moyers: Could it happen here?

Yves Smith: If things, if we have another crisis and things aren't addressed, I could see this definitely happening maybe not nationally but in significant regional pockets. I mean, you know, this is a country full of guns. And people don't like to think about what happens when people are pushed, you know, I mean, the kind of random violence, the sort of, you know, going postal phenomena?

Matt Taibbi: When I was in a foreclosure court last year. I spent a week in a foreclosure court in Jacksonville.

Bill Moyers: Reporting on it.

Matt Taibbi: Reporting on it. And the amount of raw anger that you see in these proceedings from people who have lost their homes, they have no illusions about who's to blame for the situation. They know exactly, you know, where the problem is. And I--

Bill Moyers: And it's where?

Matt Taibbi: It's with these banks that sold them these mortgages. And I think there's a growing awareness out there in the public, more and more people have had a personal problem on some front with Wall Street, whether it's credit card debt or a mortgage debt or they've lost their jobs. And I think there's anger and it's starting to become more organized.

Bill Moyers: Both of you trace this back to what you call fraudulent debt. Is that right?

Matt Taibbi: In the case of the mortgage markets, absolutely. I think what a lot of these, this was a fraud scheme. It's the same scam that you see here in the streets of New York when somebody's selling a phony Prada bag or a phony Rolex watch in the street. These banks were selling phony mortgages that were, they were selling them as triple A rated instruments when, in fact, they were essentially worthless.

They were highly risky, toxic instruments. And they knew it. They were buying, they were in cahoots with companies like Countrywide and Long Beach, these sort of fly-by-night mortgage operations who went out and they gave mortgages to everybody and everybody who had a pulse. They took these mortgages. They bundled them. They waved a whole bunch of phony hocus-pocus math over them and reconfigured them into triple A rated investments.

Then they went out into the world and they sold them to every customer all over the world, pensions, unions, foreign trade unions, foreign governments. And they--

Yves Smith: Trade councils in Australia. I mean, real know nothings.

Matt Taibbi: Everybody. Everybody bought this stuff. It all blew up like, everybody who was in on it knew it eventually would because they were betting against the stuff as they were selling it. And, and the, and that's why we have this, this situation that we're in now.

Yves Smith: Yeah, but even the most even if I'm giving Wall Street more credit than it deserves. But even if you take out the bad creation and selling of the product, you also have the fact that Wall Street basically demands an asymmetrical deal with contracts, that if you have a credit card deal or if you have a mortgage, if you make the tiniest, little violation, you know, we get to take our pound of flesh.

And yet if you're a union member, it's perfectly fine to break your contract. You know, our contracts count, but we can break all the other contracts in society to get our obligations honored. I mean, this is just crazy.

Matt Taibbi: But they genuinely think that they earn their money. And I think that was one of the illuminating things not only about the Dimon hearings but also the Lloyd Blankfein, slash, Goldman Sachs hearings a couple of years ago. These guys really think that they're, they have a unique and special genius that entitles them to earn the vast sums of money that they pay themselves, that somehow that they're creating all this wealth for themselves.

And they really genuinely don't think that they're getting their money-- from all of us. And to them it's irrelevant that they're getting all their money for free from the Fed and that they're lending it all out to us at five percent, 10 percent, 20 percent, you know, 25 percent. They think they deserve the money. And I think that's the scariest part.

Bill Moyers: There's a definition of a sociopath as being radically deprived of empathy. Do you see characteristics of sociopathic behavior on Wall Street?

Matt Taibbi: Absolutely.

Yves Smith: Yes.

Matt Taibbi: I'm sorry, just what Yves was talking about with, you know, the old people who were dying earlier now, people who don't have kids, who aren't going to school, garbage that's being left in the streets. That's all because some guy was sitting up in a skyscraper in Wall Street and knowingly selling some communities, some municipality a fraudulent, toxic mortgage backed security.

I mean, he knows that that instrument is going to blow up in, you know, six months, a year. But he's selling it to them anyway. But he doesn't care, you know, because he can't see it, you know? I think in the eyes of a lot of these guys if they can't see the effect, it doesn't really exist. And to me, that's classic sociopathic behavior when you're blind, you're willingly blind to the consequences.

Yves Smith: I mean, it's really the growth of the trading culture. You know, in the old days, I worked on Wall Street when Wall Street really was only criminal around the margins. I mean, you really, Goldman Sachs in those days had the expression long-term greedy which meant you didn't kill the--

Bill Moyers: Long-term what?

Yves Smith: Long-term greedy. That they were long-term greedy. And that meant you didn't kill the goose that laid the golden egg. You know, you wouldn't put your customer into egregiously bad deal. If you took a little extra, you only took it when the customer was making money, too, so if they ever figured it out they wouldn't be really upset.

That attitude has changed completely. And I attribute it significantly to the growth of derivatives. Over-the-counter derivatives where you can't see the price on an exchange. You can't see the history.

And they're much more complicated. And those started growing really in the early '90s and became, and it becomes very interwoven in the practice of finance. Because the derivatives are so complicated, you can't price compare. The risks are often bundled in within formulas that the buyers can't understand. And so they can load all kinds of basically what's equivalent to hidden fees in these things by the way they structure the risks in the terms.

So they're the perfect vehicle for stealing because you're selling, no, you're selling somebody something they can't evaluate.

Bill Moyers: When you come back, I want you to take the whole hour and explain to me what a derivative is and how it works. Okay? Is that a promise?

Matt Taibbi: Absolutely.

Bill Moyers: Alright, Yves and Matt, thank you very much for joining us.

Matt Taibbi: Thank you.

Yves Smith: Thank you.