

**Your on the
Street Reporter**



Uyless Black

**Epilogue V to *The Nearly Perfect Storm*
Crony Capitalsim**

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Preface

My intent in writing *The Nearly Perfect Storm: An American Financial and Social Failure*, and these epilogues is to spark your ire. I am not one to compose inflammatory compositions. I began my studies of the 2008 financial crisis with a neutral view of the subject, perhaps even skewed toward the financial world (specifically, the investment banking industry), reflecting my former employment at the Federal Reserve.

No longer. The more I learned about the institutions and individuals who were involved in the meltdown, the more disgusted I became. I wish this turn of events had not come about. I wish I had found the Great Recession occurred because of a downturn in a conventional business cycle. It did not.

Do not expect this series to be light-hearted, although I will attempt some gallows humor to lighten the load.

The Nearly Perfect Storm: An American Financial and Social Failure
Epilogue V: Crony Capitalism

June 18, 2013

These epilogues are written on occasion as follow ups to *The Nearly Perfect Storm: An American Financial and Social Failure*, available at Amazon, Barnes & Noble, and other book stores. Epilogue IV discusses the recent sequester in relation to the book’s examination of meritocracy and income distribution.

Quotes from The Nearly Perfect Storm about the issue.

Here is a table taken from page 157 of *The Nearly Perfect Storm*, with a few of my comments

“Below is a survey of the compensation seven top executives received in relation to the performance of the firms they headed. CEO compensation is shown in millions (M); firm performance is shown in billions (B).¹

Company	CEO	Compensation	Performance of Firm
AIG (1)	Martin Sullivan	1995-2007: \$ 49.5M	2008: Lost \$37.6B
Bear Sterns (2)	James Cayne	1998-2007: \$290.4M	2007: Leveraged 35.5 to 1
Citigroup	4 previous CEOs	1998-2007: \$483.1M	2007: Lost \$18.7B
C’trywide (3)	Angelo Mozilo	1998-2007: \$246.7M	2007/2008: Lost \$3.9B
Lehman (4)	Richard Fuld	1998-2007: \$255.9M	2008 (1 st half): Lost \$2.3B
Mer’l Lnch (5)	E. Stanley O’Neal	1999-2007: \$157.7M	2007 (2 nd half): Lost \$35.8B
WaMu (6)	Kerry Killinger	1998-2007: \$123.1M	2007 (4 th qtr): Lost \$8.0B

(1): Now a ward of Uncle Sam.
 (2): Now a ward of JPMorgan.
 (3): Now a ward of Bank of America.
 (4): Now a ward of nobody.
 (5): Purchased by Bank of America
 (5): Seized by Uncle Sam; parceled out to JPMorgan and bankruptcy courts.

An article appeared recently in *Foreign Affairs*, “The Real Story behind Executive Pay: The Myth of Crony Capitalism.” (Steven N. Kaplan, May/June 2013, 20-26.)

The major themes of the article are (a) The link between CEO’s pay packages and company performance has not been severed (as an aspect of the financial meltdown), and therefore, executives are being (routinely) called to task for poor performance, (b) the claim that corporate governance (boards) do not control these packages is a myth, (c) it is market forces that have led to the escalating pay packages for executives. That is, it is *merit* that has led to these fees. *Merit*, as in talent.

¹ Gretchen Morgenson, “Give Me Back My Paycheck,” *The New York Times*, February 22, 2009, 7.

My research indicates assertion (a) is partially correct; assertion (b) is somewhat correct, but only recently (keep the word recently in mind); assertion (c) is correct.

Assertion (a): The link between CEO's pay packages and company performance has not been severed.

In 2006 Goldman Sachs set aside \$542,000 per employee in a bonus pool, over fifteen times the annual income of an average American. These figures represent past practices. I have not seen data of current practices. If you come across some, please send to me.

Assertion (b): The claim that corporate governance (boards) do not control these packages is a myth.

If it is a myth, the boards need an overhaul. See the cited table.

Assertion (c): It is market forces that have led to the escalating pay packages for executives; that is, it is merit that has led to these fees. Merit, as in talent.

Even if Mr. Kaplan and I disagree on all three assertions, our opinions are irrelevant, as stated in the following paragraphs. For now, I find his article misleading and condescending. He states, the Occupy Wall Street movement "loudly" reminded Americans in 2011 about the fact of escalating income disparity. It is as if the word "loudly" is somehow not sufficiently intellectual and thus unbecoming to professors of finance (Mr. Kaplan is the Neubauer Family Distinguished Service Professor at the University of Chicago Booth School of Business.).

There are two points being missed by many residents of Wall Street and Ivy Halls: First, in several of Mr. Kaplan's statements, he offers that the problems have been patched-up now, so past outrages are no longer valid. They now constitute myths! Here are three quotes from his article (the underlines are mine):

Page 20: "And boards do monitor performance; executives of companies with sliding stock prices now face a much greater risk of getting fired than they did in the past."

Page 22: "...median pay suggests that since 2000, boards have become far less likely to award unusually large pay packages.

Page 24: "Another popular myth alleges that not only do CEOs receive exorbitant pay, but they do so even when they are failing." Again see the table above.

Financial Leverage

For the second point: What do we need to get ahead and stay ahead in life? We need money, perhaps accompanied with a rich spouse. Not just money for the rent, but money left-over after the rent (and other essentials) has been paid.

We need *financial control*. We need discretionary income to make yet more money. By having more of this income, we gain financial leverage. We also gain leverage on life.

Take another look at the table above. How many years of bringing home tens of millions of dollars a year does it take to gain financial leverage? Not many. For most families, a few months of a year would do just fine. For too many families, not a few months, not one month, not one week. A day or so of these salaries would fix the financial ills of hundreds of thousands of Americans. A day or so...it will never happen.

How many years of bringing home minimum wage would it take to gain financial leverage? It would never happen.

And that is the sobering aspect of this situation. Taking license with using the personal, “you,” if you are born (totally by chance) into a family that has financial leverage, the chances are overwhelming that you, too, will have financial leverage. Why? Because it will have been passed down to you from your parents and other members of your family. You can leverage your way into prep schools, Harvard, and networked employments to gain yet more leverage. Your networks in life to obtain financial leverage have already been set up for you.

Does any of this deal with merit, with talent? Of course it does. Merit and talent rest a lot on intelligence and education. You likely possess education and intelligence in spades, because of the selective breeding of your parents and their parents. Intelligent people tend to marry other intelligent people. The “landed gentry” tend to marry other members of the “landed gentry.”

Do we want to shy away from hiring the best and the brightest? Of course not. That’s life. That’s one aspect of capitalism. That is what makes for progress. But make no mistake, capitalism unto itself leads to disproportionate wealth. It reaches a point where those who inherit wealth have done nothing to earn it. Furthermore, they usually need to do little to keep and expand their inherited wealth.

A Personal Testimonial

I will offer a personal testimonial, one that could put me in the running for political office. I was born into a blue-collar ranching family. I funded my college education, working part-time jobs during school, and taking on summer jobs. After leaving schools, I started three companies with borrowings from friends and my savings. I managed to bring my net worth from minus figures (in the 1970s) to positive figures (by the mid-1980s).

I wish to pass this modest legacy to my love ones and other parties. I do not want the government to take my hard-work’s rewards away from me. Yet, my net worth is very modest in comparison to those who control most of America’s wealth. If Uncle Sam eats into my legacy to my loved ones to spread the wealth, it is faint noise. It Uncle eats into the legacy of Mssrs. Gates and Jobs, it has significance.

I could be accused of saying, “Take others’ wealth, not mine.” That is not what I mean. I am saying that some way must be found to take-away some of the wealth of the very rich and somehow distribute it back into America’s common coffer. How can this be done without creating the moral hazard of meritless handouts and anti-capitalistic bailouts? I have just crossed the threshold of posing a question and having no answer.

Taking the Kaplans to Task

But we should ask the Kaplans of the world to first acknowledge that this financial storm was created by a lot of morally-questionable people, many who outright broke the law, yet people who were not penalized for their actions. We should also ask them to give a bit of slack to those Occupy Wall Street folks, at least not to mock them, as seen in Figure 1 (which is located on page 21 of Kaplan's article).

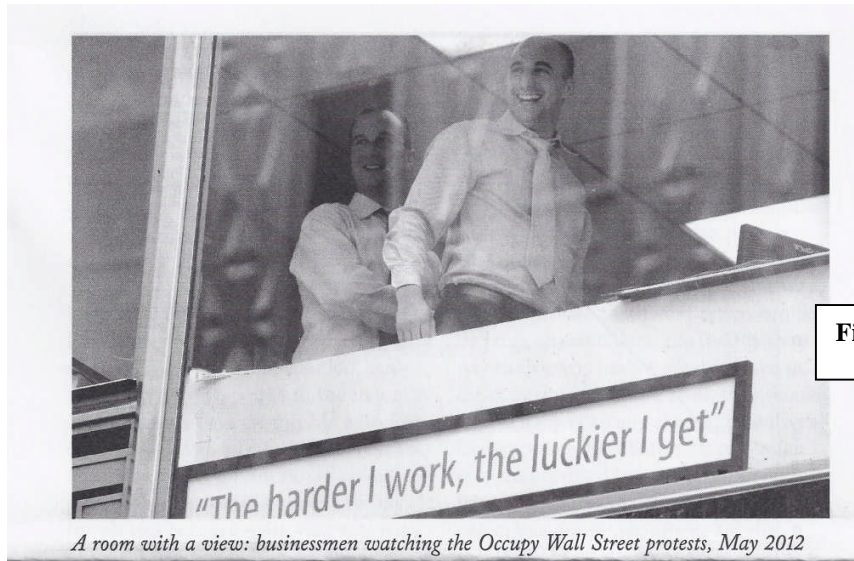


Figure 1. On top of the ladder.

It is often true that the harder one works, the “luckier” one gets. It is also true that a person is often lucky to be born with the luck of leverage.

I wrote a book (*A Swimmer's Odyssey*) about the need to “work hard” in order to succeed. This belief is instilled into my bones. But as I believe I have made clear in *The Nearly Perfect Storm*, the game on Wall Street---and increasingly, other streets in America---favor those who are already favored. That is not competition. It is not capitalism. It is not welfare capitalism. It is not state capitalism. It is crony capitalism.