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Wall Street: Unprecedented Concentration of Financial Power

Huge Financial Entities Being Formed

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In younger days I was an antitrust lawyer for a considerable number of years. Most of my work, and my cast of mind, was on the plaintiff's side. This mentality meant, and means to this day, that I favor views expressed by Justices Brandeis and Douglas: Antitrust is not simply about claimed efficiency that supposedly makes things better for consumers. The claims of efficiency are often false and consumers often get the short end of the stick. Rather than being solely about supposed efficiency, antitrust is also about fairness towards competitors, about the virtues of smallness in preference to corporate elephantiasis, about maintaining democracy by preserving economic opportunity for the small man or woman.

The Brandeisian-Douglas view has not prevailed in the last 30 to 40 years. Instead, with some of the most famous names in American law as the tip of the spear (in military terms), the field was taken over by, and federal judges learned from and implemented the views of, the economics boys — famous professors and judges who claimed that economics were all that mattered and that they, with their verbal facility and occasional mathematical models, could tell us which principles of economics to apply.

The result has been the virtual death of antitrust under the guise of making it more sophisticated. Colossal mergers, legalized price fixing, forcing unwanted products upon buyers as the price of purchasing other products which they do want, are the order of the day. The consumer and the small man or woman exists to be screwed over.

One of the ideas of the economics ist alles boys (economics is all boys) has been that corporate giganticism, whether achieved by mergers, buyouts, internal growth or howsomever, represents a desirable triumph of . . . . something. Maybe a triumph of efficiency, maybe a triumph of cost savings, maybe, if corporations in different fields are melded, a triumph of smoothing out overall corporate earnings cycles because one field will be up when the other is down, maybe a triumph of the idea that huge size and diversification would enable American companies (especially financial ones) to compete more effectively with European and Japanese ones. Creating corporate giganticism had to be a triumph, the economics boys said, because, if it weren't desirable, then hard-headed businessmen wouldn't do it.

Well, one triumph of giganticism was for certain. It was a triumph of the economics boys' theories, verbal fluency and even mathematical claims, over reality. Ignoring reality, the economics boys didn't consider that high executives from one of the previously separate corporations would be at loggerheads with executives from the other, that from top to bottom the cultures of melded corporations wouldn't mesh, that cost savings wouldn't materialize, that earnings would not be smoothed out, that purchasing corporations wouldn't know how to make good use of acquired corporations, that different industries require very different mentalities, that size was achieved by destroying highly innovative, often new companies, that companies make acquisitions not because this creates better economic entities but because it creates more power, more prestige and vast compensation for high executives, that people, including businessmen, do not act solely in accordance with the presumed economic dictates governing the rational economic man whose motivation the economics boys (falsely) like to posit as the only one to be considered, that the stock of the merged entity would tank, that ultimately there would have to be massive demerging (if I may call it that).

Nor did the economics boys reckon with another point, a point which is assailing us big time today, even as this is written, a point which is the very reason this is being written. The purveyors of "economics ist alles" did not consider that, when you create gigantic corporate organizations, you are in bigger trouble if one or a few of them make terrible mistakes or fail than if the organizations making mistakes or failing are only one third or one quarter the size.

Today there is a crisis on Wall Street. It involves enormous losses. It threatens the economy. One reason it is of such magnitude is that the institutions of Wall Street were allowed to become so huge. They are so big that their mistakes and their failures threaten all of us.

There have been Wall Street crises before that threatened or brought down the economy. I think I'm right in recollecting, and I know I'm right in some of my recollections, about how problems in the financial markets led to or threatened depressions: Such occurred in the 1830s, 1850s, 1870s, 1890s, early 1900s, and then in the Great Depression which began with the crash of 1929. After the crash of 1929, however, it was thought — I believe rightly, though economic revisionists, like many revisionists, seek to obscure the truth — that one of the causative factors was that large Wall Street houses were simultaneously both investment banks and commercial banks. They were, in other words, both sellers and traders of stocks and the kind of bank in which you and I have savings accounts and checking accounts and that make loans for houses and businesses. When the investment bank side of a house went down because it had made mistakes or the market tanked, it pulled down the commercial banking side of the house too.

One part of the solution to this was the Glass-Steagall Act, which decreed that a bank must choose to be either an investment bank or a commercial bank, but could not be both. The House of Morgan, for example, had to be split into two entirely separate banks, initially named, if I remember correctly, J.P. Morgan & Co. and Morgan Guarantee Trust. By forcing banks to be either one type of institution or the other, Glass-Steagall limited the havoc that could be caused by a horrible mistake or failure of a bank.

This worked pretty well for roughly 50 or 60 years. But then Wall Street greed (a reflection or leader of general American greed) took over. I don't remember all the details, but do remember my surprise, at what was being permitted, surprise arising from a belief in Brandeisian/Douglas principles. Wall Street figures and houses began persuading various federal agencies — if memory serves, the Federal Reserve and the Comptroller were involved at various points — to let them make inroads on the separation ordained by Glass-Steagall. It was claimed that the inroads would make them more competitive with foreign institutions, would create desirable financial supermarkets, and achieve other great things. So given institutions got into both the stock business and the commercial banking business, thus undercutting Glass-Steagall. (This is described briefly in a posting in Slate on Monday, September 15th, by Daniel Gross.) Sometimes they did insurance too. They became gigantic, and their heads were lionized by, and featured in, the mainstream mass media. Ultimately the Wall Street titans, for their own benefit, persuaded Congress to completely repeal Glass-Steagall.

Corporate elephantiasis was further increased because — antitrust and Brandeisian fear of huge size having become dead letters due to the "economics ist alles" crowd — banks that already were huge began buying up other banks, until we now have banks with assets of what — 500 or 750 billion dollars or more? (I recently read that the merged Bank of America/Merrill Lynch will control customers' assets of 2.5 trillion dollars.) Similarly, investment banks (and commercial banks) began buying up mutual fund companies and/or moving into investment-related fields that were new to them.

So, at the end of the day, so to speak, the big got even bigger, the already large became gigantic, and economic power was concentrated in fewer and fewer institutions. And, when a mistake was made, it had larger ramifications because the company making it was much larger. Even worse, when lots of institutions made the same mistake, the ramifications were that much larger because the various institutions making the mistake were that much larger and had greater effect on the economy.

Now we are seeing the results of one of the greatest mistakes ever, a mistake many of the giants engaged in, one that was an effort to repeal the financial laws of nature. It involved, as all know, subprime, adjustable rate mortgages; pushing on people mortgages they didn't understand and definitely could not afford once the adjustable rate went up — as inevitably would occur; sometimes pushing the mortgages on them by fraud; buyer ignorance (and sometimes greed); securitizing the mortgages into hugely complex tranches with differing rights and risks; pushing these so-called mortgage-backed securities onto the public; an ever rising housing market driven higher and higher by the housing purchases made possible by the scheme; and, in the end, the bursting of the bubble.

You know, there is no end to greed, is there? Perhaps ten years ago — maybe even longer — I read an article in Barron's on the mortgage securitization phenomenon, with its incomprehensible tranches, its incomprehensible, differing sets of rights and risk. The general thrust of the article was that nobody really understood the risks or who, if anyone, would come out okay if there were problems, and who would get creamed. Barron's was obviously right, and now, years later, we read almost every day that the risks (and the ever increasing complexities (including derivatives?)) were still not understood in recent days. But greed prevailed, so the effort to defy the economic laws of nature by putting people into homes they obviously could not afford prevailed, and now the whole thing has tanked, as was expectable in the circumstances. The situation was made even worse over time, and the tanking is worse now, because the institutions caught up in the whole deal are so gigantic. The fall out from the disaster is far worse than otherwise because of the institutions' size. The whole American economy, even the world economy, is threatened.

Much of the problem would almost surely have been avoided if the titans of Wall Street, the federal agencies, and the venal Congress which can be and is bought for the price of some campaign contributions, had not sought or granted exceptions to, and then ultimately repealed, Glass-Steagall, and if antitrust had not been eliminated as a significant factor by the theories of the economics boys. A few of us like myself and other MSL professors, occasionally wrote about why the demise of Glass-Steagall and the rise of ever greater elephantiasis was a dangerous thing, but we were just small fry whistling in the wind. The bigshots knew what they wanted and got it. And now look what's happened, as what was once called the madness of crowds morphed into the greedy madness of the far fewer and enormously larger.

You know, it is interesting that in recent years, even in recent days, the decades-long drive for ever greater size has begun to decline or be reversed in various fields. People are buying smaller cars. People are beginning to buy smaller houses — sometimes teeny houses. It is becoming recognized that there are great advantages to smaller schools, from grammar and high schools to universities. It is understood that small companies are often the most innovative. Small hospitals that specialize in one kind of operation are thought the best at what they do. It very well may be that god or nature or something is telling us something, is telling us, perhaps, that organizations and artifacts cannot get bigger indefinitely, that beyond a certain size dysfunctionality takes over. But the movers and shakers of the financial world and the politicians — all of whom have a major say — do not understand this yet. They still think ever bigger is ever better; indeed, one of the methods of rescue is that the already gigantic Bank of America will take over Merrill Lynch, thereby becoming even larger. (What will be the effect if the incredibly huge Bank of America now gets into deep doodoo in future years?) Well, our betters are wrong in thinking ever bigger is ever better. Instead of worshipping at the alter of size, Glass-Steagall should be reinstituted, antitrust should be used once again to protect the small guy, our other laws and practices should be conformed to the idea that smaller is often more desirable, and we all ought to begin to recognize that there are limits to how big things can get and remain workable.

Oh, and it also wouldn't hurt if we tried to curb (and punish) greed and condemn associated stupidity.