Why Big Finance Is Laughing All the Way to the Bank

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Instead of making loans to help the economy, they're shoring up their own finances and buying up their competitors.

The country's financial markets have collapsed, as they tend to do when left without adult supervision, and they're taking our economy with them. With the large banks refusing to make loans after losing billions on worthless subprime derivatives, the government stepped in and agreed to October's financial bailout package.

The $700 billion legislation was meant to buy banks' "troubled assets" for cash, and thus improve banks' balance sheets to the point that they would lend again. This would mean credit for struggling businesses and households and could encourage expansion and hiring, thus pulling us out of recession.

But it turns out the banks haven't held up their end of the bargain. All they're holding up is a glass to a government that would rather shovel cash into the largest banks than take the edge off the recession.

The bailout was highly unpopular, despite a heavy push by the U.S. political leadership. Most citizens apparently couldn't figure why we should give money to the banks that caused this crisis by buying deeply into the housing bubble. Especially when foreclosures and bankruptcies among regular homeowners are out of control — the Mortgage Bankers Association reports that "a record 1 in 10 American homeowners with a mortgage was either at least one month behind on their payments or in foreclosure at the end of September." But the plan has not been carried out as advertised — rather than buying the subprime securities from the banks, the government has instead decided to "recapitalize" them. Meaning, invest money in the big banks for some equity, money which the banks could then loan to the staggering economy. Well, at least the part where we give them money went well.

The fact is that the banks are not making loans — the "credit crunch" goes on, and the economy is the worse for it. After so many of Wall Street's great investment banks went bankrupt, or were bailed out by the government, or were bought by competitors, the banks want to "hoard cash" to avoid a similar fate. But besides shoring up their own finances, the banks are putting our public bailout money to another purpose — buying up their smaller competitors.

Mergers and acquisitions have been a major part of the government's strategy to deal with the crisis since its beginning. Bear Stearns, the first respectable Wall Street powerhouse to approach bankruptcy, was sold to the larger bank Chase in a shotgun marriage arranged by the Federal Reserve. Since then, the government has arranged for a tanking Merrill Lynch to be sold to Bank of America, a heavily leveraged Wachovia to Wells Fargo, and a failing Washington Mutual to Chase, again. The Treasury Department would say that the damage to the economy can be limited if larger, more stable banks buy their struggling rivals.

Of course, some of these largest banks, such as Citigroup, are not so secure themselves. But more than that, the money used by the larger banks to acquire the others is capital that could have been used to make the loans our economy is desperate for — and of course, that's what they were supposed to do with the public money in the first place. But most importantly, remember that the reason we're paying to bail out these banks at all is that they are "too big to fail," in the language of the business press — in other words, if these huge banks go under, the loss of employment, lending and tax revenue could do profound damage to the greater economy. So if these banks were too enormous to allow to die in the first place, why in God's name would we be paying them to get even larger?

The mergers are large-scale — the Financial Times calls them a "wave of consolidation as banks scramble to use the cash on takeovers and bolt-on acquisitions." BusinessWeek reports "what could emerge is a barbell-shaped system with megabanks, small banks and little in between." The business reporters for the New York Times describe the Treasury Department as "using the bailout bill to turn the banking system into the oligopoly of giant national institutions." An oligopoly is a market, such as banking, dominated by a few very large companies.

If any doubt remained, it was put to rest by the minor scandal that has emerged over a quiet change to the tax code made by the Treasury Department. This change allows banks to apply the losses of other banks they buy against their own taxes. In other words, when a bank buys a struggling smaller bank, the buyer can deduct the money lost by the struggling bank against its own tax bill. This is clearly meant to further encourage merger activity — for example, when Wells Fargo bought Wachovia, it paid $15 billion. But Wachovia's losses total over $19 billion. Meaning, Wells Fargo was paid by the government for buying a highly valuable bank, for a profit of $4 billion, at our expense.

By way of comparison, the SCHIP program granting health insurance to children in low-income families cost about $5 billion in 2007.

In fairness to the Treasury Department, Secretary Henry Paulson has been urging banks to use our public money to lend more. But tax breaks speak louder than words. It also might be pointed out that in Britain, banks are being recapitalized in a similar way as here, but the U.K. requires banks to formally agree to make loans with the public money. The American situation was described by David Walker, former U.S. comptroller: "It is the government's responsibility to set the terms and conditions on this money…They're giving it out with no rules."

This tax change may be undone if Congress confronts the Treasury, since the legislative branch is supposed to be in charge of the tax code. But the intention of the Treasury Department to encourage mergers at the top of the banking world is very clear.

In fact, the government is going to great lengths to avoid doing what little the Brits have done. Rather than require our banks to make loans with the bailout money, our central bank, the Federal Reserve, "has already started a campaign to lend directly to damaged financial markets and companies — nearly anyone with collateral … officials have effectively concluded that if banks and financial markets won't extend credit, it will do part of the job for them." This is according to the Wall Street Journal, which also reports that Paulson "acknowledged that banks aren't lending enough money despite the government infusion, but said the U.S. didn't want to nationalize the industry and dictate the loans banks make." Our government will do anything, even supply the economy with credit itself, before it will tell our huge banks what to do.

So to summarize, after creating a national economic crisis by wildly overinvesting in securities representing bad loans, the banks are being paid, by us, to become even larger. In spite of their being too big to fail in the first place, and even if that means the government has to do the banks' job for them. Of course, with 1 in 10 mortgages in delinquency and job losses mounting, it's easy to come up with some better uses of our tax money. But it would take a whole lot of us putting down the snack chips, turning off "When Celebrities Attack" and organizing ourselves to put pressure on the government and change the economic system. The "megabanks" of our "oligopoly of giant national institutions" aren't going to overthrow themselves.

And you can take that to the bank. The one remaining bank.

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