

Rolling Stone

The Great American Bubble Machine

From tech stocks to high gas prices, Goldman Sachs has engineered every major market manipulation since the Great Depression -- and they're about to do it again

by: Matt Taibbi



Illustration by Victor Juhasz

The first thing you need to know about Goldman Sachs is that it's everywhere. The world's most powerful investment bank is a great vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money. In fact, the history of the recent financial crisis, which doubles as a history of the rapid decline and fall of the suddenly swindled dry American empire, reads like a Who's Who of Goldman Sachs graduates.

[Invasion of the Home Snatchers](#)

By now, most of us know the major players. As George Bush's last Treasury secretary, former Goldman CEO Henry Paulson was the architect of the bailout, a suspiciously self-serving plan to funnel trillions of Your Dollars to a handful of his old friends on Wall Street. Robert Rubin, Bill Clinton's former Treasury secretary, spent 26 years at Goldman before becoming chairman of Citigroup — which in turn got a \$300 billion taxpayer bailout from Paulson. There's John Thain, the asshole chief of Merrill Lynch who bought an \$87,000 area rug for his office as his company was imploding; a former Goldman banker, Thain enjoyed a multi-billion-dollar handout from Paulson, who used billions in taxpayer funds to help Bank of America rescue Thain's sorry company. And Robert Steel, the former Goldmanite head of Wachovia, scored himself

and his fellow executives \$225 million in golden-parachute payments as his bank was self-destructing. There's Joshua Bolten, Bush's chief of staff during the bailout, and Mark Patterson, the current Treasury chief of staff, who was a Goldman lobbyist just a year ago, and Ed Liddy, the former Goldman director whom Paulson put in charge of bailed-out insurance giant AIG, which forked over \$13 billion to Goldman after Liddy came on board. The heads of the Canadian and Italian national banks are Goldman alums, as is the head of the World Bank, the head of the New York Stock Exchange, the last two heads of the Federal Reserve Bank of New York — which, incidentally, is now in charge of overseeing Goldman — not to mention

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This article appeared in the [July 9, 2009](#) issue of Rolling Stone. The issue is available in the [online archive](#).

But then, any attempt to construct a narrative around all the former Goldmanites in influential positions quickly becomes an absurd and pointless exercise, like trying to make a list of everything. What you need to know is the big picture: If America is circling the drain, Goldman Sachs has found a way to be that drain — an extremely unfortunate loophole in the system of Western democratic capitalism, which never foresaw that in a society governed passively by free markets and free elections, organized greed always defeats disorganized democracy.

The bank's unprecedented reach and power have enabled it to turn all of America into a giant pump-and-dump scam, manipulating whole economic sectors for years at a time, moving the dice game as this or that market collapses, and all the time gorging itself on the unseen costs that are breaking families everywhere — high gas prices, rising consumer credit rates, half-eaten pension funds, mass layoffs, future taxes to pay off bailouts. All that money that you're losing, it's going somewhere, and in both a literal and a figurative sense, Goldman Sachs is where it's going: The bank is a huge, highly sophisticated engine for converting the useful, deployed wealth of society into the least useful, most wasteful and insoluble substance on Earth — pure profit for rich individuals.

[The Feds vs. Goldman](#)

They achieve this using the same playbook over and over again. The formula is relatively simple: Goldman positions itself in the middle of a speculative bubble, selling investments they know are crap. Then they Hoover up vast sums from the middle and lower floors of society with the aid of a crippled and corrupt state that allows it to rewrite the rules in exchange for the relative pennies the bank throws at political patronage. Finally, when it all goes bust, leaving millions of ordinary citizens broke and starving, they begin the entire process over again, riding in to rescue us all by lending us back our own money at interest, selling themselves as men above greed, just a bunch of really smart guys keeping the wheels greased. They've been pulling this same stunt over and over since the 1920s — and now they're preparing to do it again, creating what may be the biggest and most audacious bubble yet.

If you want to understand how we got into this financial crisis, you have to first understand where all the money went — and in order to understand that, you need to understand what Goldman has already gotten away with. It is a history exactly five bubbles long — including last year's strange and seemingly inexplicable spike in the price of oil. There were a lot of losers in each of those bubbles, and in the bailout that followed. But Goldman wasn't one of them.

BUBBLE #1 The Great Depression

Goldman wasn't always a too-big-to-fail Wall Street behemoth, the ruthless face of kill-or-be-killed capitalism on steroids — just almost always. The bank was actually founded in 1869 by a German immigrant named Marcus Goldman, who built it up with his son-in-law Samuel Sachs. They were pioneers in the use of commercial paper, which is just a fancy way of saying they made money lending out short-term IOUs to smalltime vendors in downtown Manhattan.

You can probably guess the basic plotline of Goldman's first 100 years in business: plucky, immigrant-led investment bank beats the odds, pulls itself up by its bootstraps, makes shitloads of money. In that ancient history there's really only one episode that bears scrutiny now, in light of more recent events: Goldman's disastrous foray into the speculative mania of pre-crash Wall Street in the late 1920s.

[Wall Street's Big Win](#)

This great Hindenburg of financial history has a few features that might sound familiar. Back then, the main financial tool used to bilk investors was called an "investment trust." Similar to modern mutual funds, the trusts took the cash of investors large and small and (theoretically, at least) invested it in a smorgasbord of Wall Street securities, though the securities and amounts were often kept hidden from the public. So a regular guy could invest \$10 or \$100 in a trust and feel like he was a big player. Much as in the 1990s, when new vehicles like day trading and e-trading attracted reams of new suckers from the sticks who wanted to feel like big shots, investment trusts roped a new generation of regular-guy investors into the speculation game.

Beginning a pattern that would repeat itself over and over again, Goldman got into the investment trust game late, then jumped in with both feet and went hogwild. The first effort was the Goldman Sachs Trading Corporation; the bank issued a million shares at \$100 apiece, bought all those shares with its own money and then sold 90 percent of them to the hungry public at \$104. The trading corporation then relentlessly bought shares in itself, bidding the price up further and further. Eventually it dumped part of its holdings and sponsored a new trust, the Shenandoah Corporation, issuing millions more in shares in that fund — which in turn sponsored yet another trust called the Blue Ridge Corporation. In this way, each investment trust served as a front for an endless investment pyramid: Goldman hiding behind Goldman hiding behind Goldman. Of the 7,250,000 initial shares of Blue Ridge, 6,250,000 were actually owned by Shenandoah — which, of course, was in large part owned by Goldman Trading.

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The end result (ask yourself if this sounds familiar) was a daisy chain of borrowed money, one exquisitely vulnerable to a decline in performance anywhere along the line. The basic idea isn't hard to follow. You take a dollar and borrow nine against it; then you take that \$10 fund and borrow \$90; then you take your \$100 fund and, so long as the public is still lending, borrow and invest \$900. If the last fund in the line starts to lose value, you no longer have the money to pay back your investors, and everyone gets massacred.

In a chapter from *The Great Crash, 1929* titled "In Goldman Sachs We Trust," the famed economist John Kenneth Galbraith held up the Blue Ridge and Shenandoah trusts as classic examples of the insanity of leverage-based investment. The trusts, he wrote, were a major cause of the market's historic crash; in today's dollars, the losses the bank suffered totaled \$475 billion. "It is difficult not to marvel at the imagination which was implicit in this gargantuan insanity," Galbraith observed, sounding like Keith Olbermann in an ascot. "If there must be madness, something may be said for having it on a heroic scale."



Illustration by Victor Juhasz BUBBLE #2 Tech Stocks

Fast-forward about 65 years. Goldman not only survived the crash that wiped out so many of the investors it duped, it went on to become the chief underwriter to the country's wealthiest and most powerful corporations. Thanks to Sidney Weinberg, who rose from the rank of janitor's assistant to head the firm, Goldman became the pioneer of the initial public offering, one of the principal and most lucrative means by which companies raise money. During the 1970s and 1980s, Goldman may not have been the planet-eating Death Star of political influence it is today, but it was a top-drawer firm that had a reputation for attracting the very smartest talent on the Street.

It also, oddly enough, had a reputation for relatively solid ethics and a patient approach to investment that shunned the fast buck; its executives were trained to adopt the firm's mantra, "long-term greedy." One former Goldman banker who left the firm in the early Nineties recalls seeing his superiors give up a very profitable deal on the grounds that it was a long-term loser. "We gave back money to 'grownup' corporate clients who had made bad deals with us," he says. "Everything we did was legal and fair — but 'long-term greedy' said we didn't want to make such a profit at the clients' collective expense that we spoiled the marketplace."

But then, something happened. It's hard to say what it was exactly; it might have been the fact that Goldman's cochairman in the early Nineties, Robert Rubin, followed Bill Clinton to the White House, where he directed the National Economic Council and eventually became Treasury secretary. While the American media fell in love with the story line of a pair of baby-boomer, Sixties-child, Fleetwood Mac yuppies nesting in the White House, it also nursed an undisguised crush on Rubin, who was hyped as without a doubt the smartest person ever to walk the face of the Earth, with Newton, Einstein, Mozart and Kant running far behind.

Rubin was the prototypical Goldman banker. He was probably born in a \$4,000 suit, he had a face that seemed permanently frozen just short of an apology for being so much smarter than you, and he exuded a Spock-like, emotion-neutral exterior; the only human feeling you could imagine him experiencing was a nightmare about being forced to fly coach. It became almost a national cliché that whatever Rubin thought was best for the economy — a phenomenon that reached its apex in 1999, when Rubin appeared on the cover of *Time* with his Treasury deputy, Larry Summers, and Fed chief Alan Greenspan under the headline *The Committee To Save The World*. And "what Rubin thought," mostly, was that the American economy, and in particular the financial markets, were over-regulated and needed to be set free. During his tenure at Treasury, the Clinton White House made a series of moves that would have drastic consequences for the global economy — beginning with Rubin's complete and total failure to regulate his old firm during its first mad dash for obscene short-term profits.

The basic scam in the Internet Age is pretty easy even for the financially illiterate to grasp. Companies that weren't much more than potfueled ideas scrawled on napkins by uptodate bongsmokers were taken public via IPOs, hyped in the media and sold to the public for mega-millions. It was as if banks like Goldman were wrapping ribbons around watermelons, tossing them out 50-story windows and opening the phones for bids. In this game you were a winner only if you took your money out before the melon hit the pavement.

It sounds obvious now, but what the average investor didn't know at the time was that the banks had changed the rules of the game, making the deals look better than they actually were. They did this by setting up what was, in reality, a two-tiered investment system — one for the insiders who knew the real numbers, and another for the lay investor who was invited to chase soaring prices the banks themselves knew were irrational. While Goldman's later pattern would be to capitalize on changes in the regulatory environment, its key innovation in the Internet years was to abandon its own industry's standards of quality control.

"Since the Depression, there were strict underwriting guidelines that Wall Street adhered to when taking a company public," says one prominent hedge-fund manager. "The company had to be in business for a minimum of five years, and it had to show profitability for three consecutive years. But Wall Street took these guidelines and threw them in the trash." Goldman completed the snow job by pumping up the sham

stocks: "Their analysts were out there saying Bullshit.com is worth \$100 a share."

The problem was, nobody told investors that the rules had changed. "Everyone on the inside knew," the manager says. "Bob Rubin sure as hell knew what the underwriting standards were. They'd been intact since the 1930s."

Jay Ritter, a professor of finance at the University of Florida who specializes in IPOs, says banks like Goldman knew full well that many of the public offerings they were touting would never make a dime. "In the early Eighties, the major underwriters insisted on three years of profitability. Then it was one year, then it was a quarter. By the time of the Internet bubble, they were not even requiring profitability in the foreseeable future."

Goldman has denied that it changed its underwriting standards during the Internet years, but its own statistics belie the claim. Just as it did with the investment trust in the 1920s, Goldman started slow and finished crazy in the Internet years. After it took a little-known company with weak financials called Yahoo! public in 1996, once the tech boom had already begun, Goldman quickly became the IPO king of the Internet era. Of the 24 companies it took public in 1997, a third were losing money at the time of the IPO. In 1999, at the height of the boom, it took 47 companies public, including stillborns like Webvan and eToys, investment offerings that were in many ways the modern equivalents of Blue Ridge and Shenandoah. The following year, it underwrote 18 companies in the first four months, 14 of which were money losers at the time. As a leading underwriter of Internet stocks during the boom, Goldman provided profits far more volatile than those of its competitors: In 1999, the average Goldman IPO leapt 281 percent above its offering price, compared to the Wall Street average of 181 percent.

How did Goldman achieve such extraordinary results? One answer is that they used a practice called "laddering," which is just a fancy way of saying they manipulated the share price of new offerings. Here's how it works: Say you're Goldman Sachs, and Bullshit.com comes to you and asks you to take their company public. You agree on the usual terms: You'll price the stock, determine how many shares should be released and take the Bullshit.com CEO on a "road show" to schmooze investors, all in exchange for a substantial fee (typically six to seven percent of the amount raised). You then promise your best clients the right to buy big chunks of the IPO at the low offering price — let's say Bullshit.com's starting share price is \$15 — in exchange for a promise that they will buy more shares later on the open market. That seemingly simple demand gives you inside knowledge of the IPO's future, knowledge that wasn't disclosed to the day trader schmucks who only had the prospectus to go by: You know that certain of your clients who bought X amount of shares at \$15 are also going to buy Y more shares at \$20 or \$25, virtually guaranteeing that the price is going to go to \$25 and beyond. In this way, Goldman could artificially jack up the new company's price, which of course was to the bank's benefit — a six percent fee of a \$500 million IPO is serious money.

Goldman was repeatedly sued by shareholders for engaging in laddering in a variety of Internet IPOs, including Webvan and NetZero. The deceptive practices also caught the attention of Nicholas Maier, the syndicate manager of Cramer & Co., the hedge fund run at the time by the now-famous chattering television asshole Jim Cramer, himself a Goldman alum. Maier told the SEC that while working for Cramer between 1996 and 1998, he was repeatedly forced to engage in laddering practices during IPO deals with Goldman.

"Goldman, from what I witnessed, they were the worst perpetrator," Maier said. "They totally fueled the bubble. And it's specifically that kind of behavior that has caused the market crash. They built these stocks upon an illegal foundation — manipulated up — and ultimately, it really was the small person who ended up buying in." In 2005, Goldman agreed to pay \$40 million for its laddering violations — a puny penalty relative to the enormous profits it made. (Goldman, which has denied wrongdoing in all of the cases it has settled, refused to respond to questions for this story.)

Another practice Goldman engaged in during the Internet boom was "spinning," better known as bribery. Here the investment bank would offer the executives of the newly public company shares at extra-low prices, in exchange for future underwriting business. Banks that engaged in spinning would then undervalue the initial offering price — ensuring that those "hot" opening-price shares it had handed out to insiders would be more likely to rise quickly, supplying bigger first-day rewards for the chosen few. So instead of

Bullshit.com opening at \$20, the bank would approach the Bullshit.com CEO and offer him a million shares of his own company at \$18 in exchange for future business — effectively robbing all of Bullshit's new shareholders by diverting cash that should have gone to the company's bottom line into the private bank account of the company's CEO.

In one case, Goldman allegedly gave a multimillion-dollar special offering to eBay CEO Meg Whitman, who later joined Goldman's board, in exchange for future i-banking business. According to a report by the House Financial Services Committee in 2002, Goldman gave special stock offerings to executives in 21 companies that it took public, including Yahoo! cofounder Jerry Yang and two of the great slithering villains of the financial-scandal age — Tyco's Dennis Kozlowski and Enron's Ken Lay. Goldman angrily denounced the report as "an egregious distortion of the facts" — shortly before paying \$110 million to settle an investigation into spinning and other manipulations launched by New York state regulators. "The spinning of hot IPO shares was not a harmless corporate perk," then-attorney general Eliot Spitzer said at the time. "Instead, it was an integral part of a fraudulent scheme to win new investment-banking business."

Such practices conspired to turn the Internet bubble into one of the greatest financial disasters in world history: Some \$5 trillion of wealth was wiped out on the NASDAQ alone. But the real problem wasn't the money that was lost by shareholders, it was the money gained by investment bankers, who received hefty bonuses for tampering with the market. Instead of teaching Wall Street a lesson that bubbles always deflate, the Internet years demonstrated to bankers that in the age of freely flowing capital and publicly owned financial companies, bubbles are incredibly easy to *inflate*, and individual bonuses are actually bigger when the mania and the irrationality are greater.

Nowhere was this truer than at Goldman. Between 1999 and 2002, the firm paid out \$28.5 billion in compensation and benefits — an average of roughly \$350,000 a year per employee. Those numbers are important because the key legacy of the Internet boom is that the economy is now driven in large part by the pursuit of the enormous salaries and bonuses that such bubbles make possible. Goldman's mantra of "long-term greedy" vanished into thin air as the game became about getting your check before the melon hit the pavement.

The market was no longer a rationally managed place to grow real, profitable businesses: It was a huge ocean of Someone Else's Money where bankers hauled in vast sums through whatever means necessary and tried to convert that money into bonuses and payouts as quickly as possible. If you laddered and spun 50 Internet IPOs that went bust within a year, so what? By the time the Securities and Exchange Commission got around to fining your firm \$110 million, the yacht you bought with your IPO bonuses was already six years old. Besides, you were probably out of Goldman by then, running the U.S. Treasury or maybe the state of New Jersey. (One of the truly comic moments in the history of America's recent financial collapse came when Gov. Jon Corzine of New Jersey, who ran Goldman from 1994 to 1999 and left with \$320 million in IPO-fattened stock, insisted in 2002 that "I've never even heard the term 'laddering' before.")

For a bank that paid out \$7 billion a year in salaries, \$110 million fines issued half a decade late were something far less than a deterrent —they were a joke. Once the Internet bubble burst, Goldman had no incentive to reassess its new, profit-driven strategy; it just searched around for another bubble to inflate. As it turns out, it had one ready, thanks in large part to Rubin.



Illustration by Victor Juhasz
BUBBLE #3 The Housing Craze

Goldman's role in the sweeping global disaster that was the housing bubble is not hard to trace. Here again, the basic trick was a decline in underwriting standards, although in this case the standards weren't in IPOs but in mortgages. By now almost everyone knows that for decades mortgage dealers insisted that home buyers be able to produce a down payment of 10 percent or more, show a steady income and good credit rating, and possess a real first and last name. Then, at the dawn of the new millennium, they suddenly threw all that shit out the window and started writing mortgages on the backs of napkins to cocktail waitresses and ex-cons carrying five bucks and a Snickers bar.

None of that would have been possible without investment bankers like Goldman, who created vehicles to package those shitty mortgages and sell them en masse to unsuspecting insurance companies and pension funds. This created a mass market for toxic debt that would never have existed before; in the old days, no bank would have wanted to keep some addict ex-con's mortgage on its books, knowing how likely it was to fail. You can't write these mortgages, in other words, unless you can sell them to someone who doesn't know what they are.

Goldman used two methods to hide the mess they were selling. First, they bundled hundreds of different mortgages into instruments called Collateralized Debt Obligations. Then they sold investors on the idea that, because a bunch of those mortgages would turn out to be OK, there was no reason to worry so much about the shitty ones: The CDO, as a whole, was sound. Thus, junk-rated mortgages were turned into AAA-rated investments. Second, to hedge its own bets, Goldman got companies like AIG to provide insurance — known as credit default swaps — on the CDOs. The swaps were essentially a racetrack bet between AIG and Goldman: Goldman is betting the ex-cons will default, AIG is betting they won't.

There was only one problem with the deals: All of the wheeling and dealing represented exactly the kind of dangerous speculation that federal regulators are supposed to rein in. Derivatives like CDOs and credit swaps had already caused a series of serious financial calamities: Procter & Gamble and Gibson Greetings both lost fortunes, and Orange County, California, was forced to default in 1994. A report that year by the Government Accountability Office recommended that such financial instruments be tightly regulated — and in 1998, the head of the Commodity Futures Trading Commission, a woman named Brooksley Born, agreed. That May, she circulated a letter to business leaders and the Clinton administration suggesting that banks be required to provide greater disclosure in derivatives trades, and maintain reserves to cushion against losses.

More regulation wasn't exactly what Goldman had in mind. "The banks go crazy — they want it stopped," says Michael Greenberger, who worked for Born as director of trading and markets at the CFTC and is now

a law professor at the University of Maryland. "Greenspan, Summers, Rubin and [SEC chief Arthur] Levitt want it stopped."

Clinton's reigning economic foursome — "especially Rubin," according to Greenberger — called Born in for a meeting and pleaded their case. She refused to back down, however, and continued to push for more regulation of the derivatives. Then, in June 1998, Rubin went public to denounce her move, eventually recommending that Congress strip the CFTC of its regulatory authority. In 2000, on its last day in session, Congress passed the now-notorious Commodity Futures Modernization Act, which had been inserted into an 11,000-page spending bill at the last minute, with almost no debate on the floor of the Senate. Banks were now free to trade default swaps with impunity.

But the story didn't end there. AIG, a major purveyor of default swaps, approached the New York State Insurance Department in 2000 and asked whether default swaps would be regulated as insurance. At the time, the office was run by one Neil Levin, a former Goldman vice president, who decided against regulating the swaps. Now freed to underwrite as many housing-based securities and buy as much credit-default protection as it wanted, Goldman went berserk with lending lust. By the peak of the housing boom in 2006, Goldman was underwriting \$76.5 billion worth of mortgage-backed securities — a third of which were sub-prime — much of it to institutional investors like pensions and insurance companies. And in these massive issues of real estate were vast swamps of crap.

Take one \$494 million issue that year, GSAMP Trust 2006S3. Many of the mortgages belonged to second-mortgage borrowers, and the average equity they had in their homes was *0.71 percent*. Moreover, 58 percent of the loans included little or no documentation — no names of the borrowers, no addresses of the homes, just zip codes. Yet both of the major ratings agencies, Moody's and Standard & Poor's, rated 93 percent of the issue as investment grade. Moody's projected that less than 10 percent of the loans would default. In reality, 18 percent of the mortgages were in default *within 18 months*.

Not that Goldman was personally at any risk. The bank might be taking all these hideous, completely irresponsible mortgages from beneath-gangster-status firms like Countrywide and selling them off to municipalities and pensioners — old people, for God's sake — pretending the whole time that it wasn't grade D horseshit. But even as it was doing so, it was taking short positions in the same market, in essence betting against the same crap it was selling. Even worse, Goldman bragged about it in public. "The mortgage sector continues to be challenged," David Viniar, the bank's chief financial officer, boasted in 2007. "As a result, we took significant markdowns on our long inventory positions ... However, our risk bias in that market was to be short, *and that net short position was profitable*." In other words, the mortgages it was selling were for chumps. The real money was in betting against those same mortgages.

"That's how audacious these assholes are," says one hedge fund manager. "At least with other banks, you could say that they were just dumb — they believed what they were selling, and it blew them up. Goldman knew what it was doing."

I ask the manager how it could be that selling something to customers that you're actually betting against — particularly when you know more about the weaknesses of those products than the customer — doesn't amount to securities fraud.

"It's exactly securities fraud," he says. "It's the *heart* of securities fraud."

Eventually, lots of aggrieved investors agreed. In a virtual repeat of the Internet IPO craze, Goldman was hit with a wave of lawsuits after the collapse of the housing bubble, many of which accused the bank of withholding pertinent information about the quality of the mortgages it issued. New York state regulators are suing Goldman and 25 other underwriters for selling bundles of crappy Countrywide mortgages to city and state pension funds, which lost as much as \$100 million in the investments. Massachusetts also investigated Goldman for similar misdeeds, acting on behalf of 714 mortgage holders who got stuck holding predatory loans. But once again, Goldman got off virtually scot-free, staving off prosecution by agreeing to pay a paltry \$60 million — about what the bank's CDO division made in a day and a half during the real estate boom.

The effects of the housing bubble are well known — it led more or less directly to the collapse of Bear Stearns, Lehman Brothers and AIG, whose toxic portfolio of credit swaps was in significant part composed of the insurance that banks like Goldman bought against their own housing portfolios. In fact, at least \$13 billion of the taxpayer money given to AIG in the bailout ultimately went to Goldman, meaning that the bank made out on the housing bubble twice: It fucked the investors who bought their horseshit CDOs by betting against its own crappy product, then it turned around and fucked the taxpayer by making him pay off those same bets.

And once again, while the world was crashing down all around the bank, Goldman made sure it was doing just fine in the compensation department. In 2006, the firm's payroll jumped to \$16.5 billion — an average of \$622,000 per employee. As a Goldman spokesman explained, "We work very hard here."

But the best was yet to come. While the collapse of the housing bubble sent most of the financial world fleeing for the exits, or to jail, Goldman boldly doubled down — and almost single-handedly created yet another bubble, one the world still barely knows the firm had anything to do with.

BUBBLE #4 \$4 a Gallon



Illustration by Victor Juhasz

By the beginning of 2008, the financial world was in turmoil. Wall Street had spent the past two and a half decades producing one scandal after another, which didn't leave much to sell that wasn't tainted. The terms *junk bond*, *IPO*, *sub-prime mortgage* and other once-hot financial fare were now firmly associated in the public's mind with scams; the terms *credit swaps* and *CDOs* were about to join them. The credit markets were in crisis, and the mantra that had sustained the fantasy economy throughout the Bush years — the notion that housing prices never go down — was now a fully exploded myth, leaving the Street clamoring for a new bullshit paradigm to sling.

Where to go? With the public reluctant to put money in anything that felt like a paper investment, the Street quietly moved the casino to the physical-commodities market — stuff you could touch: corn, coffee, cocoa, wheat and, above all, energy commodities, especially oil. In conjunction with a decline in the dollar, the credit crunch and the housing crash caused a "flight to commodities." Oil futures in particular skyrocketed, as the price of a single barrel went from around \$60 in the middle of 2007 to a high of \$147 in the summer of 2008.

That summer, as the presidential campaign heated up, the accepted explanation for why gasoline had hit \$4.11 a gallon was that there was a problem with the world oil supply. In a classic example of how Republicans and Democrats respond to crises by engaging in fierce exchanges of moronic irrelevancies,

John McCain insisted that ending the moratorium on offshore drilling would be "very helpful in the short term," while Barack Obama in typical liberal-arts yuppie style argued that federal investment in hybrid cars was the way out.

But it was all a lie. While the global supply of oil will eventually dry up, the short-term flow has actually been increasing. In the six months before prices spiked, according to the U.S. Energy Information Administration, the world oil supply rose from 85.24 million barrels a day to 85.72 million. Over the same period, world oil demand dropped from 86.82 million barrels a day to 86.07 million. Not only was the short-term supply of oil rising, the demand for it was falling — which, in classic economic terms, should have brought prices at the pump down.

So what caused the huge spike in oil prices? Take a wild guess. Obviously Goldman had help — there were other players in the physical commodities market — but the root cause had almost everything to do with the behavior of a few powerful actors determined to turn the once-solid market into a speculative casino. Goldman did it by persuading pension funds and other large institutional investors to invest in oil futures — agreeing to buy oil at a certain price on a fixed date. The push transformed oil from a physical commodity, rigidly subject to supply and demand, into something to bet on, like a stock. Between 2003 and 2008, the amount of speculative money in commodities grew from \$13 billion to \$317 billion, an increase of 2,300 percent. By 2008, a barrel of oil was traded 27 times, on average, before it was actually delivered and consumed.

As is so often the case, there had been a Depression-era law in place designed specifically to prevent this sort of thing. The commodities market was designed in large part to help farmers: A grower concerned about future price drops could enter into a contract to sell his corn at a certain price for delivery later on, which made him worry less about building up stores of his crop. When no one was buying corn, the farmer could sell to a middleman known as a "traditional speculator," who would store the grain and sell it later, when demand returned. That way, someone was always there to buy from the farmer, even when the market temporarily had no need for his crops.

In 1936, however, Congress recognized that there should never be more speculators in the market than real producers and consumers. If that happened, prices would be affected by something other than supply and demand, and price manipulations would ensue. A new law empowered the Commodity Futures Trading Commission — the very same body that would later try and fail to regulate credit swaps — to place limits on speculative trades in commodities. As a result of the CFTC's oversight, peace and harmony reigned in the commodities markets for more than 50 years.

All that changed in 1991 when, unbeknownst to almost everyone in the world, a Goldman-owned commodities-trading subsidiary called J. Aron wrote to the CFTC and made an unusual argument. Farmers with big stores of corn, Goldman argued, weren't the only ones who needed to hedge their risk against future price drops — Wall Street dealers who made big bets on oil prices also needed to hedge their risk, because, well, they stood to lose a lot too.

This was complete and utter crap — the 1936 law, remember, was specifically designed to maintain distinctions between people who were buying and selling real tangible stuff and people who were trading in paper alone. But the CFTC, amazingly, bought Goldman's argument. It issued the bank a free pass, called the "Bona Fide Hedging" exemption, allowing Goldman's subsidiary to call itself a physical hedger and escape virtually all limits placed on speculators. In the years that followed, the commission would quietly issue 14 similar exemptions to other companies.

Now Goldman and other banks were free to drive more investors into the commodities markets, enabling speculators to place increasingly big bets. That 1991 letter from Goldman more or less directly led to the oil bubble in 2008, when the number of speculators in the market — driven there by fear of the falling dollar and the housing crash — finally overwhelmed the real physical suppliers and consumers. By 2008, at least three quarters of the activity on the commodity exchanges was speculative, according to a congressional staffer who studied the numbers — and that's likely a conservative estimate. By the middle of last summer, despite rising supply and a drop in demand, we were paying \$4 a gallon every time we pulled up to the pump.

What is even more amazing is that the letter to Goldman, along with most of the other trading exemptions, was handed out more or less in secret. "I was the head of the division of trading and markets, and Brooksley Born was the chair of the CFTC," says Greenberger, "and neither of us knew this letter was out there." In fact, the letters only came to light by accident. Last year, a staffer for the House Energy and Commerce Committee just happened to be at a briefing when officials from the CFTC made an offhand reference to the exemptions.

"I had been invited to a briefing the commission was holding on energy," the staffer recounts. "And suddenly in the middle of it, they start saying, 'Yeah, we've been issuing these letters for years now.' I raised my hand and said, 'Really? You issued a letter? Can I see it?' And they were like, 'Duh, duh.' So we went back and forth, and finally they said, 'We have to clear it with Goldman Sachs.' I'm like, 'What do you mean, you have to clear it with Goldman Sachs?'"

The CFTC cited a rule that prohibited it from releasing any information about a company's current position in the market. But the staffer's request was about a letter that had been issued 17 years earlier. It no longer had anything to do with Goldman's current position. What's more, Section 7 of the 1936 commodities law gives Congress the right to any information it wants from the commission. Still, in a classic example of how complete Goldman's capture of government is, the CFTC waited until it got clearance from the bank before it turned the letter over.

Armed with the semi-secret government exemption, Goldman had become the chief designer of a giant commodities betting parlor. Its Goldman Sachs Commodities Index — which tracks the prices of 24 major commodities but is overwhelmingly weighted toward oil — became the place where pension funds and insurance companies and other institutional investors could make massive long-term bets on commodity prices. Which was all well and good, except for a couple of things. One was that index speculators are mostly "long only" bettors, who seldom if ever take short positions — meaning they only bet on prices to rise. While this kind of behavior is good for a stock market, it's terrible for commodities, because it continually forces prices upward. "If index speculators took short positions as well as long ones, you'd see them pushing prices both up and down," says Michael Masters, a hedge fund manager who has helped expose the role of investment banks in the manipulation of oil prices. "But they only push prices in one direction: up."

Complicating matters even further was the fact that Goldman itself was cheerleading with all its might for an increase in oil prices. In the beginning of 2008, Arjun Murti, a Goldman analyst, hailed as an "oracle of oil" by *The New York Times*, predicted a "super spike" in oil prices, forecasting a rise to \$200 a barrel. At the time Goldman was heavily invested in oil through its commodities trading subsidiary, J. Aron; it also owned a stake in a major oil refinery in Kansas, where it warehoused the crude it bought and sold. Even though the supply of oil was keeping pace with demand, Murti continually warned of disruptions to the world oil supply, going so far as to broadcast the fact that he owned two hybrid cars. High prices, the bank insisted, were somehow the fault of the piggish American consumer; in 2005, Goldman analysts insisted that we wouldn't know when oil prices would fall until we knew "when American consumers will stop buying gas-guzzling sport utility vehicles and instead seek fuel-efficient alternatives."

But it wasn't the consumption of real oil that was driving up prices — it was the trade in paper oil. By the summer of 2008, in fact, commodities speculators had bought and stockpiled enough oil futures to fill 1.1 billion barrels of crude, which meant that speculators owned more future oil on paper than there was real, physical oil stored in all of the country's commercial storage tanks and the Strategic Petroleum Reserve combined. It was a repeat of both the Internet craze and the housing bubble, when Wall Street jacked up present-day profits by selling suckers shares of a fictional fantasy future of endlessly rising prices.

In what was by now a painfully familiar pattern, the oil-commodities melon hit the pavement hard in the summer of 2008, causing a massive loss of wealth; crude prices plunged from \$147 to \$33. Once again the big losers were ordinary people. The pensioners whose funds invested in this crap got massacred: CalPERS, the California Public Employees' Retirement System, had \$1.1 billion in commodities when the crash came. And the damage didn't just come from oil. Soaring food prices driven by the commodities bubble led to catastrophes across the planet, forcing an estimated 100 million people into hunger and sparking food riots throughout the Third World.

Now oil prices are rising again: They shot up 20 percent in the month of May and have nearly doubled so far this year. Once again, the problem is not supply or demand. "The highest supply of oil in the last 20 years is now," says Rep. Bart Stupak, a Democrat from Michigan who serves on the House energy committee. "Demand is at a 10-year low. And yet prices are up."

Asked why politicians continue to harp on things like drilling or hybrid cars, when supply and demand have nothing to do with the high prices, Stupak shakes his head. "I think they just don't understand the problem very well," he says. "You can't explain it in 30 seconds, so politicians ignore it."

BUBBLE #5 Rigging the Bailout

After the oil bubble collapsed last fall, there was no new bubble to keep things humming — this time, the money seems to be really gone, like worldwide-depression gone. So the financial safari has moved elsewhere, and the big game in the hunt has become the only remaining pool of dumb, unguarded capital left to feed upon: taxpayer money. Here, in the biggest bailout in history, is where Goldman Sachs really started to flex its muscle.

It began in September of last year, when then-Treasury secretary Paulson made a momentous series of decisions. Although he had already engineered a rescue of Bear Stearns a few months before and helped bail out quasi-private lenders Fannie Mae and Freddie Mac, Paulson elected to let Lehman Brothers — one of Goldman's last real competitors — collapse without intervention. ("Goldman's superhero status was left intact," says market analyst Eric Salzman, "and an investment banking competitor, Lehman, goes away.") The very next day, Paulson green-lighted a massive, \$85 billion bailout of AIG, which promptly turned around and repaid \$13 billion it owed to Goldman. Thanks to the rescue effort, the bank ended up getting paid in full for its bad bets: By contrast, retired auto workers awaiting the Chrysler bailout will be lucky to receive 50 cents for every dollar they are owed.

Immediately after the AIG bailout, Paulson announced his federal bailout for the financial industry, a \$700 billion plan called the Troubled Asset Relief Program, and put a heretofore unknown 35-year-old Goldman banker named Neel Kashkari in charge of administering the funds. In order to qualify for bailout monies, Goldman announced that it would convert from an investment bank to a bank holding company, a move that allows it access not only to \$10 billion in TARP funds, but to a whole galaxy of less conspicuous, publicly backed funding — most notably, lending from the discount window of the Federal Reserve. By the end of March, the Fed will have lent or guaranteed at least \$8.7 trillion under a series of new bailout programs — and thanks to an obscure law allowing the Fed to block most congressional audits, both the amounts and the recipients of the monies remain almost entirely secret.

Converting to a bank-holding company has other benefits as well: Goldman's primary supervisor is now the New York Fed, whose chairman at the time of its announcement was Stephen Friedman, a former co-chairman of Goldman Sachs. Friedman was technically in violation of Federal Reserve policy by remaining on the board of Goldman even as he was supposedly regulating the bank; in order to rectify the problem, he applied for, and got, a conflict of interest waiver from the government. Friedman was also supposed to divest himself of his Goldman stock after Goldman became a bank holding company, but thanks to the waiver, he was allowed to go out and buy 52,000 *additional* shares in his old bank, leaving him \$3 million richer. Friedman stepped down in May, but the man now in charge of supervising Goldman — New York Fed president William Dudley — is yet another former Goldmanite.

The collective message of all this — the AIG bailout, the swift approval for its bank holding conversion, the TARP funds — is that when it comes to Goldman Sachs, there isn't a free market at all. The government might let other players on the market die, but it simply will not allow Goldman to fail under any circumstances. Its edge in the market has suddenly become an open declaration of supreme privilege. "In the past it was an implicit advantage," says Simon Johnson, an economics professor at MIT and former official at the International Monetary Fund, who compares the bailout to the crony capitalism he has seen in Third World countries. "Now it's more of an explicit advantage."

Once the bailouts were in place, Goldman went right back to business as usual, dreaming up impossibly

convoluted schemes to pick the American carcass clean of its loose capital. One of its first moves in the post-bailout era was to quietly push forward the calendar it uses to report its earnings, essentially wiping December 2008 — with its \$1.3 billion in pretax losses — off the books. At the same time, the bank announced a highly suspicious \$1.8 billion profit for the first quarter of 2009 — which apparently included a large chunk of money funneled to it by taxpayers via the AIG bailout. "They cooked those first quarter results six ways from Sunday," says one hedge fund manager. "They hid the losses in the orphan month and called the bailout money profit."

Two more numbers stand out from that stunning first-quarter turnaround. The bank paid out an astonishing \$4.7 billion in bonuses and compensation in the first three months of this year, an 18 percent increase over the first quarter of 2008. It also raised \$5 billion by issuing new shares almost immediately after releasing its first quarter results. Taken together, the numbers show that Goldman essentially borrowed a \$5 billion salary payout for its executives in the middle of the global economic crisis it helped cause, using half-baked accounting to reel in investors, just months after receiving billions in a taxpayer bailout.

Even more amazing, Goldman did it all right before the government announced the results of its new "stress test" for banks seeking to repay TARP money — suggesting that Goldman knew exactly what was coming. The government was trying to carefully orchestrate the repayments in an effort to prevent further trouble at banks that couldn't pay back the money right away. But Goldman blew off those concerns, brazenly flaunting its insider status. "They seemed to know everything that they needed to do before the stress test came out, unlike everyone else, who had to wait until after," says Michael Hecht, a managing director of JMP Securities. "The government came out and said, 'To pay back TARP, you have to issue debt of at least five years that is not insured by FDIC — which Goldman Sachs had already done, a week or two before.'"

And here's the real punch line. After playing an intimate role in four historic bubble catastrophes, after helping \$5 trillion in wealth disappear from the NASDAQ, after pawing off thousands of toxic mortgages on pensioners and cities, after helping to drive the price of gas up to \$4 a gallon and to push 100 million people around the world into hunger, after securing tens of billions of taxpayer dollars through a series of bailouts overseen by its former CEO, what did Goldman Sachs give back to the people of the United States in 2008?

Fourteen million dollars.

That is what the firm paid in taxes in 2008, an effective tax rate of exactly one, read it, one percent. The bank paid out \$10 billion in compensation and benefits that same year and made a profit of more than \$2 billion — yet it paid the Treasury less than a third of what it forked over to CEO Lloyd Blankfein, who made \$42.9 million last year.

How is this possible? According to Goldman's annual report, the low taxes are due in large part to changes in the bank's "geographic earnings mix." In other words, the bank moved its money around so that most of its earnings took place in foreign countries with low tax rates. Thanks to our completely fucked corporate tax system, companies like Goldman can ship their revenues offshore and defer taxes on those revenues indefinitely, even while they claim deductions upfront on that same untaxed income. This is why any corporation with an at least occasionally sober accountant can usually find a way to zero out its taxes. A GAO report, in fact, found that between 1998 and 2005, roughly two-thirds of all corporations operating in the U.S. paid no taxes at all.

This should be a pitchfork-level outrage — but somehow, when Goldman released its post-bailout tax profile, hardly anyone said a word. One of the few to remark on the obscenity was Rep. Lloyd Doggett, a Democrat from Texas who serves on the House Ways and Means Committee. "With the right hand out begging for bailout money," he said, "the left is hiding it offshore."

BUBBLE #6 Global Warming

Fast-forward to today. It's early June in Washington, D.C. Barack Obama, a popular young politician whose leading private campaign donor was an investment bank called Goldman Sachs — its employees paid some

\$981,000 to his campaign — sits in the White House. Having seamlessly navigated the political minefield of the bailout era, Goldman is once again back to its old business, scouting out loopholes in a new government-created market with the aid of a new set of alumni occupying key government jobs.

Gone are Hank Paulson and Neel Kashkari; in their place are Treasury chief of staff Mark Patterson and CFTC chief Gary Gensler, both former Goldmanites. (Gensler was the firm's co-head of finance.) And instead of credit derivatives or oil futures or mortgage-backed CDOs, the new game in town, the next bubble, is in carbon credits — a booming trillion dollar market that barely even exists yet, but will if the Democratic Party that it gave \$4,452,585 to in the last election manages to push into existence a groundbreaking new commodities bubble, disguised as an "environmental plan," called cap-and-trade.

The new carbon credit market is a virtual repeat of the commodities-market casino that's been kind to Goldman, except it has one delicious new wrinkle: If the plan goes forward as expected, the rise in prices will be government-mandated. Goldman won't even have to rig the game. It will be rigged in advance.

Here's how it works: If the bill passes, there will be limits for coal plants, utilities, natural-gas distributors and numerous other industries on the amount of carbon emissions (a.k.a. greenhouse gases) they can produce per year. If the companies go over their allotment, they will be able to buy "allocations" or credits from other companies that have managed to produce fewer emissions. President Obama conservatively estimates that about \$646 billion worth of carbon credits will be auctioned in the first seven years; one of his top economic aides speculates that the real number might be twice or even three times that amount.

The feature of this plan that has special appeal to speculators is that the "cap" on carbon will be continually lowered by the government, which means that carbon credits will become more and more scarce with each passing year. Which means that this is a brand new commodities market where the main commodity to be traded is guaranteed to rise in price over time. The volume of this new market will be upwards of a trillion dollars annually; for comparison's sake, the annual combined revenues of all electricity suppliers in the U.S. total \$320 billion.

Goldman wants this bill. The plan is (1) to get in on the ground floor of paradigm-shifting legislation, (2) make sure that they're the profit-making slice of that paradigm and (3) make sure the slice is a big slice. Goldman started pushing hard for cap-and-trade long ago, but things really ramped up last year when the firm spent \$3.5 million to lobby climate issues. (One of their lobbyists at the time was none other than Patterson, now Treasury chief of staff.) Back in 2005, when Hank Paulson was chief of Goldman, he personally helped author the bank's environmental policy, a document that contains some surprising elements for a firm that in all other areas has been consistently opposed to any sort of government regulation. Paulson's report argued that "voluntary action alone cannot solve the climate change problem." A few years later, the bank's carbon chief, Ken Newcombe, insisted that cap-and-trade alone won't be enough to fix the climate problem and called for further public investments in research and development. Which is convenient, considering that Goldman made early investments in wind power (it bought a subsidiary called Horizon Wind Energy), renewable diesel (it is an investor in a firm called Changing World Technologies) and solar power (it partnered with BP Solar), exactly the kind of deals that will prosper if the government forces energy producers to use cleaner energy. As Paulson said at the time, "We're not making those investments to lose money."

The bank owns a 10 percent stake in the Chicago Climate Exchange, where the carbon credits will be traded. Moreover, Goldman owns a minority stake in Blue Source LLC, a Utah-based firm that sells carbon credits of the type that will be in great demand if the bill passes. Nobel Prize winner Al Gore, who is intimately involved with the planning of cap-and-trade, started up a company called Generation Investment Management with three former bigwigs from Goldman Sachs Asset Management, David Blood, Mark Ferguson and Peter Harris. Their business? Investing in carbon offsets. There's also a \$500 million Green Growth Fund set up by a Goldmanite to invest in green-tech ... the list goes on and on. Goldman is ahead of the headlines again, just waiting for someone to make it rain in the right spot. Will this market be bigger than the energy futures market?

"Oh, it'll dwarf it," says a former staffer on the House energy committee.