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Talking Business

Short Memories at Goldman

By JOE NOCERA

A few weeks ago, shortly after Goldman Sachs reported its latest blowout quarter, the firm’s chief executive, Lloyd Blankfein, spoke at a Fortune magazine breakfast.

In normal times, Mr. Blankfein might have been forgiven for bragging a bit about the just-reported quarter — over $3 billion in profit on $12 billion in revenue. It had generated some $6 billion just in one division: fixed income. It had more than $160 billion in cash or cash equivalents on its balance sheet. And of course it had long since repaid, with interest, the $10 billion it had accepted from the Treasury Department during the darkest days of the crisis.

But of course those weren’t the numbers the media and the public had focused on in the wake of Goldman’s earnings. Instead, people were fixated on the $5.3 billion the firm had set aside for its executives’ year-end bonuses. Added to first and second quarter set-asides of $4.6 billion and $6.6 billion, the firm had put aside $16 billion so far this year for employee bonuses. Nearly 50 percent of the firm’s revenue was going toward compensation. And there was still one more quarter to go!

Was it fair, commentators kept asking, that barely a year after the taxpayers had essentially saved the financial system, this firm that took government capital should now be paying multimillion-dollar bonuses? Was it right? Which, not surprisingly, is what Fortune’s managing editor, Andrew Serwer, asked Mr. Blankfein within minutes of taking the stage.

In private, Goldman executives are scornful of the sentiment behind this question. Their view, in essence, is that they should be applauded for being able to pay such big bonuses, because it means their business is successful. People who want them to pay less, they believe, want them to fail.

But Mr. Blankfein, a charming, funny man who has been Goldman's boss since 2006, is far too smart to say that out loud. Nonetheless, what he did say was revealing. Treasury's original decision to use the Troubled Asset Relief Program to shore up the banks' capital, Mr. Blankfein said, "was a sensible thing to do at the time."

But, he added, "If I had known it was as pregnant with this kind of potential for backlash, then of course I would have really not have liked it." When I later asked Goldman's chief spokesman, Lucas van Praag, if Mr. Blankfein was basically saying that he wished he hadn't taken the TARP money, Mr. van Praag said my interpretation was correct.

By focusing on the TARP money — which the firm insists it never really needed anyway — Mr. Blankfein seemed to be saying that that direct injection of capital was the only way the government had come to Goldman's aid. And without it, there wouldn't even be any question about paying those big bonuses.

But it's worth taking a moment now to count the various ways Goldman depended on the government's good will both during and after the crisis. It was a lot more than just the TARP money. In fact, those bonuses that Goldman executives are about to pull down owe a fair amount to us taxpayers. Goldman's failure to even concede that point is a large part of the reason the firm is under such scrutiny now.

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I say this as someone who is most certainly not a Goldman conspiracy theorist. I do not believe that Goldman is a "vampire squid" that has been at the root of every financial crisis since the Depression, as Rolling Stone magazine claimed a few months ago. I don't believe that Henry Paulson Jr., then the Treasury secretary, saved the American International Group because he was really trying to save Goldman Sachs — even if he was Goldman's former chief executive. (I think he did it to prevent the financial system from collapsing completely.)

I don't even believe that there was anything wrong with all the phone conversations Mr. Paulson had with Mr. Blankfein in the fall of 2008. It was a crisis, for crying out loud. During times of trouble, it makes perfect sense that you would talk to people with whom you'd shared a foxhole during past crises.

And I also think it is important to give the company its due: it is really good at what it does. "They went through the crisis like everyone else," said Brad Hintz, the analyst who follows the firm for Sanford C. Bernstein & Company. "But they recovered faster and they didn't make mistakes." Mr. Hintz added that after Lehman went bankrupt, some 20 percent of the fixed-income market share was up for grabs. "Goldman was able to take advantage of that," he said. "They were able to get their trades done."

Ah, yes, but why were they able to get their trades done? One reason is that Goldman had far more capital at its disposal than any other firm. In a market like this one — with interest rates so low they are practically negligible (which is itself a government policy that greatly aids Goldman Sachs), and with competitors either hobbled or out of business, capital is basically the only thing you need to make money hand over fist. That $10 billion of TARP money meant that Goldman Sachs could free up an additional $10 billion to put to work making money — instead of having to use it to shore up its capital. Indeed, when the firm paid back the TARP money last summer, it went out and raised new capital so that it wouldn't have to reduce the amount it could deploy to make money.

In addition, early in the crisis, at a time when lending had essentially frozen, the Federal Deposit Insurance Corporation set up an emergency program to guarantee commercial paper loans. Like every other firm, Goldman took advantage of that program, borrowing $28 billion (it has since reduced that amount to $21 billion). Although that program is about to be eliminated, I saw an analysis in The Wall Street Journal recently showing that Goldman was likely to save around $754 million over the life of the guarantee program.

Then there was the fact that during their moment of maximum vulnerability, the government let Morgan Stanley and Goldman Sachs become bank holding companies — something it had earlier refused to allow Lehman Brothers to do. In practical terms, it wasn't all that big a deal; it primarily meant the two firms were going to be regulated by the Federal Reserve rather than the Securities and Exchange Commission.

But in psychological terms, coming at a time when Wall Street was openly questioning whether Morgan and Goldman would be able to survive the panic, it was huge. It meant that the Federal Reserve was standing by the two firms, and it helped calm the storm.

More? How about the government's decision to save A.I.G. — and make all the counterparties whole? Although Goldman insists that it had hedged its A.I.G. exposure, a collapse of the firm would have been devastating for the financial system, Goldman very much included. And of course the government wound up paying off all the A.I.G. counterparties at 100 cents on the dollar, which in Goldman's case amounted to $12.9 billion.

Then there was the Term Asset-Backed Securities Loan Facility, set up by the Fed, which allowed firms to buy up distressed securities and sell them for a very healthy profit to someone who was part of the TALF program. You don't think Goldman Sachs did plenty of that? Traders I know say Goldman traders were all over those assets — and made millions trading the securities.

Finally, there is the biggest benefit of all, a benefit that seems blazingly obvious to just about anybody who doesn't work at Goldman Sachs. The government will never, ever let it fail. That's what the events of last fall proved.

Goldman Sachs insists that it doesn't run its operation with that expectation. It has reduced its balance sheet, raised plenty of capital and lowered its risk profile. But of all the too-big-to-fail institutions, Goldman is the only one that remains a pure investment bank. It doesn't make loans to small businesses like Citigroup and JPMorgan Chase, nor does it sell stocks to individuals, like Merrill Lynch and, increasingly, Morgan Stanley.

Goldman makes its money primarily by taking trading risks, and so long as that is the case, American taxpayers are going to question why they should have to be on the hook if Goldman suddenly runs into serious trouble. And they are going to resent those big bonuses, which their tax dollars helped generate, knowing that those same tax dollars will race to the rescue if Goldman should ever come close to the brink.

At that Fortune breakfast, Mr. Blankfein noted that for 130 of Goldman's 140-year existence, the firm was a private partnership. Its executives were paid bonuses out of a pool of earnings that built up over the year. If the company took unjustified risks, it was the partners themselves who paid the price, in smaller bonuses.

Goldman is no longer a private partnership. It is a large, publicly traded company. "But they are still paying themselves like partners — without the risk and personal exposure and accountability that they had when they were a partnership," said Jesse Brill, a well-known critic of executive compensation practices. What other business, after all, pays 50 percent of revenue to its employees in the form of bonuses? What other business knows that it will never have to face bankruptcy, no matter what?

Still, the premise of the firm — then and now — is that those who contribute to its success should reap the rewards. So let's add it up: the $12.9 billion in A.I.G. help, the $10 billion in TARP, the F.D.I.C. guarantee program, the easy money trading distressed securities into the TALF program. I can't say for sure how much of the $16 billion the firm has set aside for bonuses can be attributed to government assistance of one form or another. But it's got to be a fairly substantial amount — at least $2 billion or $3 billion.

Which leads to one last question for Mr. Blankfein.

Where's our bonus?