**"After the Deluge: A Look at Washington, Wall Street and Main Street Post-Meltdown"**

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I don't know about you but looking back to the dire economic events of 2008, it seems hardly possible that two years have passed. It still feels so fresh in my mind, that Sunday that Lehman Brothers, one of the oldest names on Wall Street went bankrupt. The Tuesday night that AIG, the world's largest insurance company, was rescued by the government; the weekend that Treasury decided to take over Fannie Mae and Freddie Mac, two of the largest financial institutions on the planet, that were about to implode.

It was a stunning and tragic time for everyone. But for those of us in the business press who were trying to make sense of what was happening, it was truly surreal. I remember sitting at my desk watching the stock market plunge, knowing that even more harrowing things were going on in markets that were opaque and hidden from view, including the derivatives markets and mortgages.

I am so glad that terrifying period is behind us.

Or is it?

Two years after the deluge, after the events that we broadly call the panic of 2008 or the credit crisis, most of the nation remains very much in its throes. Not everyone, mind you. Inhabitants of some quarters, such as Wall Street, are thriving. And the stock market, which stands at around 11,000 if you're looking at the Dow, represents a rare bright spot on our financial horizon. Corporate earnings are expected to increase 45 percent in 2010 over last year.

But the fact that the debacle and its aftermath continue to affect so many people is undeniable. Unemployment remains stubbornly high. Consumer debt levels are still in the stratosphere. Household wealth, meanwhile, has plummeted – largely a result of crumbling home prices. Consumer confidence is low and consumer spending, which accounts for 2/3 of gross domestic product, is moribund.

While the government tells us that the Great Recession ended in June 2009, for many people this statistic is at odds with what they see and feel every day. The fact is, prolonged period of economic pain is a new and disturbing experience for many Americans who have grown accustomed, in recent years, to financial crises that pass relatively quickly.

Think about it. Over the past twenty-five years, Americans have learned that the typical financial storm blows in and then out fairly fast, leaving behind some, but not massive amounts of, damage. Since the mid-1980's that has been our experience.

The stock market crash of October 1987, for example, when the major stock indices lost one-fifth of their value in one day, was a certifiably horrifying event. But share prices recovered a lot of their losses within days and by the time two years had passed, stocks were back at Pre-Crash levels.

The Savings & Loan failures of the late 1980's were another example of a contained crisis. While it is true that 1,000 banks collapsed during the period and these troubles contributed to a nationwide recession a few years later, the mess subsided without disastrous consequences.

Ditto for the 1998 collapse of Long Term Capital Management, the giant hedge fund, and the bursting of the Internet stock bubble in 2000. Investors absorbed big losses, but they were by no means crippling.

No one welcomed these incidents, or enjoyed them, as they were occurring. But because their effects were relatively muted, these financial disturbances left many Americans singularly unprepared for the deep and lasting turmoil we are currently in.

Even if you accept the recent report from the National Bureau of Economic Research that the recession ended in June 2009, that would make the duration of this downturn 18 months, the second longest after the Great Depression. Previous contractions in the post-World War II era lasted an average of ten months; the Great Depression lasted 43.

But 24 months after the disastrous autumn of '08 why aren't we experiencing a stronger economy? Because we are in the midst of a protracted, enormous and excruciating deleveraging process. We are purging the debt that we amassed during the credit binge of the early 2000s and that process will take much longer than many may have thought because the size of the asset bubble and the debt that funded it was so unbelievably huge.

Because ours was a crisis built on debt, and massive amounts of it, its after-effects will be felt for a long time. Debt is a wonderful thing when prices are rising because it can amplify an investor's gains. But when losses result, debt works to magnify them. That's because while asset prices fall, the amount of debt used to buy those assets stays at the same level, until it is paid down or written off.

This is one of the hardest lessons an investor has to learn—the assets might shrink but the debt doesn't.

And so you have legions of homeowners across the country carrying mortgages that exceed the value of the property underlying them by a considerable amount. According to CoreLogic, a research firm, 23 percent of borrowers nationwide are underwater on their mortgages. Massachusetts has almost 19 percent of borrowers upside down on their mortgages. In the state of Nevada, 71 percent of mortgages have a value greater than the properties that underlie them while half of borrowers in Florida are in this boat.

The assets shrink but the debt doesn't.

At the end of the first quarter, American households owed a total of $13.5 trillion to their lenders, representing 120 percent of their after-tax incomes. At the peak of the bubble, in the second half of 2007, household debt stood at 130 percent of disposable income, more than twice the level seen one generation earlier. And that was a record, at the time.

Most of this $13.5 trillion is mortgage debt, which stands at $10 trillion. To get it back to a more manageable level, economists at Goldman Sachs believe that figure will have to decline by $3 trillion. Most of the decline, as much as $2 trillion, will consist of subprime loans which probably should have never been made in the first place.

One reason why this deleveraging will take so much longer than usual is that the leveraging went so much further than it ever had before. Throughout the late 90s and into the 2000s, personal incomes were stagnant. But costs of healthcare, college educations and real estate were rising. So, consumers withdrew money from their homes to cover the difference between income and outflow. They did this through home equity loans and second liens offered by E-Z money lenders.

The amounts of this indebtedness taken on, as property prices were soaring, was just plain staggering. In 2005 alone, homeowners extracted three quarters of a trillion dollars from their homes, spending two-thirds of it on personal consumption, home improvements and paying down credit card debt. During the three years of 2005, 6 and 7, borrowers were extracting between $600 billion and $800 billion a year from their homes.

While the real estate bubble was expanding, these debts were secured by properties whose prices were rocketing. Now these borrowings are unsecured because the real estate assets beneath them have plunged in value.

While mortgages are by far the largest debt held by consumers, our credit card obligations, car loans and the like are also considerable. Today these debts stand at $2.4 trillion; to return to a sustainable level they would have to decline by as much as 20 percent.

For overall debt levels to be manageable, economists say that debt should be about 80 percent of disposable income, down from 120% now. For almost four decades, beginning in the early 1960s and extending through the mid-1990s, the debt-to-disposable income level had remained in a range of between 58% on the low side to 85% on the high side.

You can see how wild and wooly this debt accumulation got in recent years. And you can also see why consumer spending is in the doldrums. Many people are wisely using any extra money they generate now to pay down their borrowings, to cut up their high-cost credit cards and kick the debt habit. The number of open credit card accounts was down 23 percent recently from the highs reached during the second quarter of 2008.

Still, this deleveraging process cannot happen overnight. And economists say that if the recent pace of debt work-down continues and if household incomes grow modestly, it might be eight years before we return to equilibrium.

A McKinsey Global Institute study of past deleveraging episodes showed that the typical downshift during the aftermath lasts six to seven years.

We've lived through two painful years already. If these estimates are correct, we've got about five or six years to go.

In the meantime, Americans are in a world of hurt. Halfway through the year, 11.4 percent of outstanding consumer debt was delinquent, totaling $1.3 trillion. Almost $1 trillion of that is seriously delinquent, which means at least 90 days late.

A half-million people had a foreclosure added to their credit reports between March 31 and June 30, an increase of 8.7 percent over the first quarter of the year. And the numbers of consumers with new bankruptcies appearing on their credit reports rose 34 percent during the quarter, to 621,000. That increase is significantly bigger than it has been in the last few years, according to the Fed Reserve.

The recent Census figures also indicate the misery out there. In 2009, there were 44 million Americans living in poverty, more than have ever been recorded in the 51 years these statistics have been collected. Our nation's poverty rate stands at 14.3 percent of the population; saddest of all, children are the fastest growing impoverished group, increasing 8.7 percent last year over 2008.

Putting some of this in perspective, poverty has increased faster during this recession than it did during the brutal economic downturn of 1973.

The Census also shows that workers' wages have stagnated or fallen for the past decade. Median household income was $49,777 in 2009, roughly static from a year earlier, but down 5 percent from the peak in household income of $52,388 that occurred in 1999.

Incomes aren't the only thing that's falling. The Federal Reserve Board recently reported that the wealth of U.S. households declined by 2.8 percent in the second quarter of 2010. Household net worth, which consists of stocks, bonds, real estate and other assets minus mortgages and other debts, stood at $53.5 trillion.

Is it any wonder that consumers are worried? Confidence among consumers, which drive 70 percent of our nation's gross domestic product, fell unexpectedly in September to 48.5 from 53.2 in August.

This is pretty downbeat stuff, I acknowledge. But I also know that Americans are an ingenious, indomitable and hardworking people and we have what it takes to climb out of this massive hole we've dug ourselves into. It's just that it's going to be a long and difficult slog. Our days of instant gratification are behind us.

This is not a bad thing in my view. The concept of shopping 'til you drop using borrowed money, was never a sustainable one. Loading oneself with debt is a type of enslavement, after all, and understanding the implications of this is crucial for a healthy society. I for one am hopeful that a lesson learned in this crisis is that less can be more for many consumers.

But while consumers may be learning hard lessons from this crisis, many in positions of power on Wall Street and Washington are not. While Main Street suffers, Wall Street and Washington thrive.

This disparity, a scenario where pain is not shared by all of those involved in a problem, is deeply disturbing to many in America. I know, because I receive searing, angry or just plain bewildered messages from readers across the country. Why, they ask, are banks being allowed to force troubled borrowers from their homes without proving they have the right to do so under the law? Why are the regulators in Washington, the same folks who failed so utterly in their duties to rein in the reckless lending that almost blew up the economy, now being rewarded with even more responsibility? Why are some of the very people who were on the scene of this particular crime in positions of even greater power now?

Others wonder why no government agency or law enforcement group has tried to recover some of the many millions of dollars in compensation given to the heads of companies that later failed or required bailout money?

And the most common question of all—why has no one involved in this crisis gone to jail?

Now you have a taste of what fills up my email box daily. And even more distressing than the questions, is that I have no satisfactory answers to them.

Yes, the mess of 2008 is over. And yes, the Great Recession may have ended too. But, we are still in a very perilous place even as the crisis recedes and that is because people understand more clearly than ever that there are two sets of rules in America. One set, which the citizenry receives, can be described as tough love. If you borrowed to buy a house that went down in value and that you can no longer afford because you have lost your job, that's your problem. Get over it.

But for the institutions that created our problems, there is a kinder and more forgiving set of rules. If they took on too much risk during the mortgage mania, they get a taxpayer bailout. Their problems are everyone's problems. Let's throw money at them.

I'd like to read you an email I received recently in response to my column about how the recent Dodd Frank law actually increases the potential for government backstops in the future.

> "Ms. Morgenson—Don't you think it interesting that the self proclaimed geniuses of Wall Street need a back stop? (Because their—hedges, etc.—don't work.) Don't you think it interesting that they use the government to make us provide that back stop? Isn't it interesting that they say we, the people, don't need the back stop of Medicare or that evil, evil Social Security?"

What this reader is getting at is the heart of the problem our country faces today, the dueling rules I mentioned a minute ago that have created a mass sense of mistrust in government and business leaders. Americans are rightfully outraged that those who created the crisis, both on Wall Street and in Washington, continue to get taxpayer help or take no responsibility for the mess, or both.

Shame and a sense of shared sacrifice seem simply to have gone missing among many of America's leaders.

Even as the government has thrown trillions of dollars into the system to mitigate the impact of the downturn, millions of people have been forced from their homes and trust in the nation's regulators and in some of our largest and most venerable institutions has been shattered.

The problem of distrust is a huge one and can be seen in recent poll numbers published by the Associated Press and CNBC. After polling 1,035 investors, the analysis showed a majority—55 percent—said they believe the market and Wall Street is not a level playing field for all.

The perception that the market is fair to only some investors is pervasive. Nearly 90% of small investors, those with portfolios below $50,000, said the market is biased against them. And more than 75 percent of investors worth at least $250,000 said Wall Street is unfair to the little guy.

This is deeply troubling because small investors have been big participants in the market over the past generation, and losing that participation will have consequences. Not only will it be harder for companies to raise capital and create jobs, a prevailing view of unfairness also means investors will have fewer choices when they deploy their investment dollars and plan for retirement.

As for restoring faith in government, this is job one, according to the poll. It found mass mistrust in regulator's ability to police the financial system. Only 8 percent of those interviewed said they had strong confidence in financial regulators. Half of those polled expressed little or no confidence, including 16 percent who said they had no confidence at all.

This is no surprise given that almost every one of the nation's financial regulators fell asleep on the job in the years leading up to the disaster. This included the folks at the Securities and Exchange Commission, the Office of Thrift Supervision, the Comptroller of the Currency, Housing and Urban Development and the Fed. About the only group that does not appear to have been snoozing throughout was the FDIC.

Now that the taxpayers are on the hook for hundreds of billions of dollars in bailouts, I think it is high time to examine what is considered business as usual at the highest reaches of some American companies. From my perch at *The New York Times*, I see a disturbing sense of entitlement among some business leaders today that lets them justify siphoning off massive wealth from their shareholders even when their performance is mediocre or downright disastrous. And the way some of these companies treat their customers is equally troubling.

There are some who say that this crisis proves that capitalism does not work. I believe this is wrong. Capitalism still works, but it must be protected from the sorts of capitalists who take everything for themselves, leaving nothing for the rest of us.

These are the people who reap all the gains when they are taking on massive risks, but then force the taxpayer to shoulder the losses when they inevitably arise. The men at the top of Citigroup, Merrill Lynch, Washington Mutual and Bear Stearns.

This is not the way capitalism was supposed to work. Privatizing gains and socializing losses is deeply unfair, thoroughly un-American. But that is precisely what has characterized the aftermath of the credit craze.

As an ardent capitalist and a true believer in free markets, I believe it is crucial that entrepreneurs be able to raise capital to create jobs. Investors, too, can share in the benefits of wealth creation under a capitalist system. There is no country on Earth that does this better than America.

But it is because of these beliefs, that I have grown so distressed in recent years as people in high places have abused the system. It is an unfortunate truth that a few bad apples can spoil the entire barrel. A few greedmeisters can wreck the trust in the free market that is necessary for it to work.

Populist capitalism like ours is hugely beneficial to the vast majority of people, but an ethical tradition is needed to make it all work. When you have senior executives walking away with hundreds of millions, leaving shareholders and innocent taxpayers in the dirt, it becomes extremely dangerous. And as more and more jobs disappear from this country, the outsized pay amassed by corporate executives becomes even more polarizing.

Here's an annoying fact for you. Did you know that the American taxpayer is still footing the legal bills amassed by the former top executives of Fannie Mae, the mortgage finance giant, who are defending themselves against shareholder suits pertaining to their phony accounting? These bills are small in the scheme of things, only in the millions of dollars, but the mere fact that they are our responsibility is beyond exasperating.

The trouble today is that some in corporate America, together with their co-conspirators on Wall Street, have rigged the game so that executives can get immensely rich at the expense of their shareholders and often to the detriment of their workers.

Think for a moment about the hundreds of billions in losses taken by some of our largest and formerly respected financial institutions. None of the executives who ran these companies into the ground have been forced to give back compensation they earned when the losing positions were put onto their books. Yes, some of them lost money when their stock prices collapsed as their companies cratered, but so many executives had earned so much over the prior years that such losses are a fraction of their total compensation.

As these people skate from the scene of the crime, they send the rest of us a clear and dangerous message. Accountability is AWOL if you reach the highest levels of corporate America. You can collect all the gains when the party is on, but when the hangover comes, the losses are somebody else's responsibility, either your shareholders' or the taxpayers' or both.

It is dispiriting that leaders would behave this way. After all, leaders are supposed to be exemplars, people we can look up to. And yet what many have done is run away, disclaiming responsibility. Conduct unbecoming a leader of any kind.

These practices also have consequences and I think we see them most clearly in the anger and mistrust that is evident among Americans today. Trust is hard won but easily lost. And a great deal of it has been squandered in the recent failures and bailouts.

I am not only talking about trust in private institutions, like banks and other corporations, but also about our government. The credit crisis was a two-pronged failure, after all. First, was the failure by the private sector to rein itself in or to limit itself to appropriate business practices. The profits from reckless activities were simply too tantalizing and titanic to pass up for many of the executives running these institutions. The take-the-money-and-run mentality ran amok.

Second, was the abysmal regulatory performance. While Citigroup, for example, was amassing its mountain of toxic assets, regulators at the New York Fed, overseen by Timothy Geithner, were loosening the reins on the company. And the failure by people at the highest levels of our regulatory system to understand the risky practices being pursued by some of the nation's largest banks was nothing short of breathtaking. This inability to recognize peril when it was staring them in the face meant that Ben Bernanke and his colleagues were far behind when the subprime crisis began to metastasize.

According to Mr. Bernanke's calendars and schedules, for example, it was not until August 14, 2007 that the chairman of the Federal Reserve gathered his staff for a meeting to discuss subprime mortgages. Former Treasury secretary Henry Paulson's schedules indicate that the first discussion of the subprime problem occurred on September 6, 2007.

If these were indeed their first in-depth discussions about subprime, then the heads of both the Fed and the Treasury were playing a serious game of catch-up when problems in this arena erupted.

The question that remains to be answered—and that will be tackled by ethicists and others far better qualified than I—is why was greed allowed to go so viral during this period?

I think part of an explanation lies in a rejection by some business leaders of a very powerful social compact, a duty to others rather than just to self, that was once embraced by many people in powerful positions. Recognizing that they had immense sway over investors, workers and customers, they agreed to hold themselves to a higher standard of care. It was an unwritten rule perhaps, but it did guide many people for some time. Now it seems to have been supplanted by the notion that personal profits are supreme and that making it to the top means having the biggest bank account.

I don't know exactly how we recover an attention to duty and care for others in the business world. I don't know how to force people in high places to forgo profits for propriety. I know that those of us in the media can do our part by shining light on the dark corners where such behavior often flourishes.

But I have also concluded that Americans know how to right themselves when they recognize that they are headed down the wrong path. Such a shift can begin when we hold our leaders accountable and when we, as consumers and investors, protect ourselves from harm by saying no to dubious practices. By dealing whenever we can with companies that are worthy of our trust, we can help ensure that such enterprises succeed.

There are plenty of these kinds of operations, large and small, across America. And given that Washington seems pretty dysfunctional and Wall Street remains a scary place indeed, it seems increasingly obvious to me that the folks on Main Street are the only ones who can pull us out of this mess.

Faced with so many woeful stories of the people harmed in The Great Recession, I concede that it is hard to be optimistic about our future and what kind of a country we will leave to our children. But America as the land of opportunity, accountability and honesty has not vanished altogether. I prefer to think it has been only temporarily subverted. Yes, it has taken some damaging body blows. But the traits that made this country great—hard work, selflessness and honor—are still very much in us. We have just lived through a period when they weren't rewarded.

To regain confidence after enduring this mess, I believe that at least some of the people who blew up these institutions must be held accountable for their actions. Investors, pensioners, employees and taxpayers—all have been hurt by reckless risk taking at the highest levels. It will be criminal if the people who created this disaster and profited mightily from it, are allowed to slink off into the night. Then we will have confirmed the suspicion that the paths of the powerful are protected, but that the little guy must fend for himself.

And that, I hope and I pray, is not the new American Way.