INSIDE JOB

The Financiers Who Pulled Off the Heist of the Century

CHARLES FERGUSON
ANY BOOKS HAVE ALREADY been written about the financial crisis, but there are two reasons why I decided that it was still important to write this one.

The first reason is that the bad guys got away with it, and there has been stunningly little public debate about this fact. When I received the Oscar for best documentary in 2011, I said: “Three years after a horrific financial crisis caused by massive fraud, not a single financial executive has gone to jail. And that’s wrong.” When asked afterwards about the absence of prosecutions, senior officials in the Obama White House gave evasive nonanswers, suggesting that nothing illegal occurred, or that investigations were continuing. None of the major Republican candidates for the US presidency have raised the issue at all.

As of early 2012 there has still not been a single criminal prosecution of a senior financial executive related to the financial crisis. Nor has there been any serious attempt by the US government to use civil suits, asset seizures, or restraining orders to extract fines or restitution from the people responsible for plunging the world economy
inside job

into recession. This is not because we have no evidence of criminal behaviour. Since the release of my film, a large amount of new material has emerged, especially from private lawsuits, that reveals, through e-mail trails and other evidence, that many bankers, including senior management, knew exactly what was going on, and that it was highly fraudulent.

But even leaving this crisis aside, there is now abundant evidence of widespread, unpunished criminal behaviour in the financial sector. Later in this book, I go through the list of what we already know, which is a lot. In addition to the behaviour that caused the crisis, major US and European banks have been caught assisting corporate fraud by Enron and others, laundering money for drug cartels and the Iranian military, aiding tax evasion, hiding the assets of corrupt dictators, colluding in order to fix prices, and committing many forms of financial fraud. The evidence is now overwhelming that over the last thirty years, the US financial sector has become a rogue industry. As its wealth and power grew, it subverted the political system (including both American political parties), government, and academic institutions in order to free itself from regulation. As deregulation progressed, the industry became ever more unethical and dangerous, producing ever larger financial crises and ever more blatant criminality. Since the 1990s, its power has been sufficient to insulate bankers not only from effective regulation but even from criminal law enforcement. The financial sector is now a parasitic and destabilizing industry that constitutes a major drag on economic growth.

This means that criminal prosecution is not just a matter of vengeance or even justice. Real punishment for large-scale financial criminality is a vital element of the financial re-regulation that is, in turn, essential to the world’s economic health and stability. Regulation is nice, but the threat of prison focuses the mind. A noted expert, the gangster Al Capone, once said, “You can get much further in life with a kind word and a gun than with a kind word alone.” If financial executives know that they will go to jail if they commit major frauds

Where We Are Now
that endanger the world economy, and that their illegal wealth will be confiscated, then they will be considerably less likely to commit such frauds and cause global financial crises. So one reason for writing this book is to lay out in painfully clear detail the case for criminal prosecutions. In this book, I demonstrate that much of the behaviour underlying the bubble and crisis was quite literally criminal, and that the lack of prosecution is nearly as outrageous as the financial sector’s original conduct.

The second reason that I decided to write this book is that the rise of predatory finance is both a cause and a symptom of an even broader, and even more disturbing, change in the economy and political system that governs the US and the rest of the world. The American financial sector is the core of a new oligarchy that has risen to power over the past thirty years, and that has profoundly changed our way of life. The later chapters of this book are devoted to analysing how this happened and what it means.

Starting around 1980, American society began to undergo a series of deep shifts. Deregulation, weakened antitrust enforcement, and technological changes led to increasing concentration of industry and finance. Money began to play a larger and more corrupting role in politics. The shifts could be felt in education, in infrastructure, and in the performance of many major industries. Inequality increased. As a result of these and other changes, America was turning into a rigged game—a society that denies opportunity to those who are not born into wealthy families, one that resembles a third-world dictatorship more than an advanced democracy. And others are mimicking these changes, by plan or by accident.

The “Occupy” protests that began in New York City in September 2011, and then rapidly spread around the world, were initially somewhat unclear in their goals. But the protesters were deeply right about one thing: over the last thirty years, their nations have been taken over by an amoral financial oligarchy. In particular, the American dream of opportunity, education, and upward mobility is now largely con-
fined to the top few percent of the population. US government policy is increasingly dictated by the wealthy, by the financial sector, and by powerful (though sometimes badly mismanaged) industries such as telecommunications, health care, car manufacturing, and energy. These policies are implemented and praised by these groups’ willing servants, namely the increasingly bought-and-paid-for leadership of America’s political parties, academia, and lobbying industry.

If allowed to continue, this process will engender a declining, unfair society with an impoverished, angry, uneducated population under the control of a small, ultrawealthy elite. Such a society would be not only immoral but also eventually unstable, dangerously ripe for political extremism. And this will have consequences far beyond America’s shores, as the 2008 financial crisis demonstrated with great pain.

Thus far, both American political parties have been remarkably clever and effective in concealing this new reality. In fact, the two parties have formed an innovative kind of cartel—an arrangement I have termed America’s political duopoly, which I analyse in detail below. Both parties lie about the fact that they have each sold out to the financial sector and the wealthy. So far both have largely got away with the lie, helped in part by the enormous amount of money now spent on deceptive, manipulative political advertising. But that can’t last indefinitely; people are getting angry, and even when they’re misguided or poorly informed, people have a deep, visceral sense that they’re being screwed. The Occupy movement is one early, small symptom of this, but so is the Tea Party.

So I’m not going to spend much time describing ways to regulate naked credit default swaps, improve accounting standards for off-balance-sheet entities, implement the “Volcker rule”, increase core capital, or measure bank leverage. Those are important things to do, but they are tactical questions, and relatively easy to manage if you have a healthy political system, economy, academic environment, and regulatory structure. The real challenge is figuring out how ordinary citizens can regain control from the new economic oligarchy. For if we don’t, the current pattern of great concentration of wealth and power
will worsen, and we may face the steady immiseration of most of the population.

Before getting into the substance of these issues, I should perhaps make one comment about where I’m coming from. I’m not against business, or profits, or becoming wealthy. I have no problem with people becoming billionaires—if they got there by winning a fair race, if their accomplishments merit it, if they pay their fair share of taxes, and if they don’t corrupt their society. The people who founded Intel became very rich—and that’s great. They got PhDs in physics. They worked very hard. They treated their employees fairly. And they gave us a thousand times more than they took. Within a decade of its being founded, Intel invented microprocessors and the three most important forms of semiconductor memory. One of Intel’s founders—Robert Noyce, whom I once had the honour to meet—personally coinvented the integrated circuit. I have no problem at all with the fact that Bob Noyce, Gordon Moore, and Andy Grove made a lot of money. Same for Larry Ellison at Oracle, Steve Jobs and Steve Wozniak of Apple, the founders of Google, eBay, Craigslist, Amazon, and Genentech, and, for that matter, the famed investor Warren Buffett.

But that’s not how most of the people mentioned in this book became wealthy. Most of them became wealthy by being well connected and crooked. And they are creating a society in which they can commit hugely damaging economic crimes with impunity, and in which only children of the wealthy have the opportunity to become successful.

That’s what I have a problem with. And I think most people agree with me.

The View from the Bottom 99 Percent

The 2008 financial crisis was the worst global economic setback since the Great Depression. In 2007, when the financial bubble ended, US economic growth slipped to an anaemic 1.9 percent. In 2008 the nation’s GNP actually declined 0.3 percent—followed by a decline of 3.5
percent in 2009. The year 2010 finally saw a “recovery” for the US, with 3 percent GNP growth. But this hasn’t helped much. The recovery on both sides of the Atlantic has been weak and nearly jobless; in the US, GNP growth was achieved largely through investments in technology, not by hiring people, and in the UK, growth never even reached that height.¹

The post-crisis US recession officially ended in June 2009. Yet in the subsequent two years, during the “recovery”, median household income fell by nearly 7 percent. The official unemployment rate in early 2012 remained over 8 percent in both the US and the UK, while the best estimates of the real unemployment rate ranged upwards from 12 percent. Poverty, especially child poverty, was at record levels.

Since the crisis began, ten million Americans have spent more than six months out of work, and two million have been unemployed for more than two years. Many of the unemployed have exhausted their benefits, and even more would have done so were it not for temporary extensions—which were agreed to by the Republicans in the US Congress only on the condition that the Democrats agree to an expensive tax break that mostly benefits the wealthy. And the UK expects more than three million people to be registered as long-term unemployed by 2014.

Forced unemployment is damaging for anyone, but long-term unemployment is morale-breaking. Skills deteriorate, people lose their self-confidence, and many of them just give up. Long-term unemployment also, of course, contributes to home repossessions and homelessness. There are no reliable numbers, but the homeless population is clearly rising fast.² Yet, the upper 1 percent of the population has continued to increase its share of total national income and wealth, to the highest levels since the late 1920s.³

Corporate balance sheets are just fine; US-based companies, many of them with multinational reach, are sitting on two trillion dollars in cash. But governments are not fine. The crisis and recession, together with the emergency spending needed to prevent a financial holocaust, caused a 50 percent increase in national debt alone. The US national...
deficit remains out of control, and many local governments have cut essential services, including education and public safety, because they are out of money.

Meanwhile, Europe is suffering from a new, and chronic, financial crisis driven by European government debt. The European debt problem was greatly worsened by the emergency spending that had been needed to prevent the crisis of 2008 from causing a twenty-first-century Great Depression.

In the nations most severely affected by the European debt crisis—Greece, Ireland, Portugal, and Spain—living standards have declined sharply. By early 2012 Spain’s official unemployment rate was 23 percent; Portugal’s unemployment rate was 12 percent; Ireland’s was 14 percent; Greece’s was 22 percent. Greece, whose prior government had hired Goldman Sachs to help it massage its national accounts and conceal its budget deficits from the European Union, could no longer pay its $300 billion in government debt. Starting in 2011 (and as a condition for easing the repayment terms on Greece’s debts), the European Union, the European Central Bank, and the International Monetary Fund (IMF) forced Greece to institute new taxes and draconian cuts in public sector salaries and pensions. Greece has an enormous, hugely expensive patronage system, but it has thus far remained untouched; instead, most of the pain has been borne by the hardworking and honest. Teachers and university professors have suffered pay cuts of 30 percent or more, unemployment has soared, and GDP declined by 6 percent in 2011. Riots broke out in the UK, Italy, and Greece, and major protest movements arose in those countries as well as Spain, Germany, and France.4

But in many ways, it is America that has changed the most, and with the widest aftershocks for the rest of the world. For most people, salaries and total household income have been flat or declining for many years. The financial crisis, recession, and jobless “recovery” are just the latest and worst installment of a process that began many years before and has reached . In fact, even during the artificial prosperity of
the 2001–2007 financial bubble, the wages of average workers had been flat or declining, while the incomes of the wealthy were soaring.

No other developed country, even class-conscious Britain, comes remotely close to the extreme income and wealth inequalities of the US in 2012. Between 2001 and 2007, the years of the great financial bubble, the top 1 percent of US households captured half of the nation’s total income growth. This is not the way it used to be; the change started in the 1980s. The top 1 percent’s share of taxable income, including capital gains, rose from 10 percent in 1980 to 23 percent in 2007. This is the same percentage as it was in 1928, and about three times the share held by the top 1 percent during the 1950s and 1960s, when the country had far higher economic growth, and no financial crises. With the sharp drop in stock values since the financial crash, the top 1 percent’s share fell to “only” 17 percent in 2009, but has since risen again to about 20 percent. Wealth is now even more concentrated than income in America—the wealthiest 1 percent own about a third of the country’s total net worth, and over 40 percent of the country’s total financial wealth. This is more than twice the share held by the entire bottom 80 percent of the population.5

Consequently, not everyone has suffered over the last decade; American CEOs, the financial sector, the energy sector, lobbyists, and children of the already wealthy did just fine. Since 2000, America’s four largest oil companies have accumulated more than $300 billion in excess profits, defined as profits over and above their profit rate in the prior decade. Investment banking bonuses were similarly enormous—an estimated $150 billion over the decade. The average annual salary of New York bankers, which is now $390,000, stayed approximately constant even after the sector collapsed in 2008.

The flip side of the growth in inequality is an obscene, morally indefensible decline in the fairness of society—in education, job opportunities, income, wealth, and even health and life expectancy. With the exception of wealthy families, children today are now less educated than their parents, and will earn less money than their parents. Even
worse, the opportunities and lives of young people are increasingly determined by how wealthy their parents are, not by their own abilities or efforts.

Many Americans no doubt still believe in the American dream, and thus “buy in” to the rhetoric and policies put forward by the political parties to nurture it (and them). One wonders how long they can maintain that illusion, for America is transforming itself into one of the most unfair, most rigid, and least socially mobile of the industrialized countries. In the US, parental income now has about a 50 percent weight in determining a child’s lifetime economic prospects. Germany, Sweden, and even class-ridden France are now fairer and more upwardly mobile societies than the US—on average, parental incomes have only about a 30 percent weight in determining the next generation’s outcomes. The truly equitable, high-mobility societies are Canada, Norway, Denmark, and Finland, where parental income accounts for only about 20 percent of a child’s lifetime earnings. Even many “developing” nations, such as Taiwan and South Korea, now have levels of opportunity and fairness that exceed America’s. For example, someone born into a poor family in South Korea or Taiwan now has a much higher probability of graduating from school, and exiting poverty, than someone born into a poor family in America. Many of these nations’ citizens also have longer life expectancies than Americans.6

Now, having squandered trillions on mismanaged wars, tax cuts designed especially for the rich, a gigantic property bubble, and massive bailouts for its banks, the US government and its allies are confronting major fiscal problems. At the same time, America’s fundamental economic competitiveness has declined severely, as its physical infrastructure, broadband services, educational system, workforce skills, health care, and energy policies have failed to keep pace with the needs of an advanced economy—yet its policies for encouraging free enterprise are inexplicably held as a standard. However, as we shall see later, this decline is not solely, or even primarily, a matter of money; it is a matter of policy and priorities. In some areas, insufficient government spending
is indeed an issue. But in many areas, such as health care, the US as a society is spending far more than other nations, without obtaining the same results.

The principal reason for this is that politically powerful interest groups in the US have been able to block reform: the financial services, energy, military, telecommunications, pharmaceutical, and processed-food industries; the legal, accounting, and medical professions; and to a lesser extent, several unions—these and other groups, including, of course, lobbyists and politicians, have ferociously resisted efforts to improve our future at their expense.

Meanwhile, both political parties are ignoring, lying about, and/or exploiting the country’s very real economic, social, and educational problems. This process is starting to generate an additional danger: demagoguery. As America deteriorates, religious and political extremists are beginning to exploit the growing insecurity and discontent of the population. Thus far, this has principally taken the form of attacks on the government, taxes, and social spending. However, sometimes it is also taking more extreme forms: antiscientific fundamentalist Christianity; attacks on education, the teaching of evolution, vaccines, and scientific activity; and demonization of various groups such as immigrants, Muslims, and the poor.

Presiding over all this is an impressive, though utterly cynical, innovation on the part of American politicians: the political duopoly. Over the past quarter century, the leaders of both the Democratic and the Republican political parties have perfected a remarkable system for remaining in power while serving the new economic oligarchy. Both parties take in huge amounts of money, in many forms—campaign contributions, lobbying, revolving-door hiring, favours, and special access of various kinds. Politicians in both parties enrich themselves and betray the interests of the nation, including most of the people who vote for them. Yet both parties are still able to mobilize support because they skillfully exploit America’s cultural polarization. Republicans warn social conservatives about the dangers of secularism, taxes, abortion, welfare, gay marriage, gun con-
control, and liberals. Democrats warn social liberals about the dangers of
guns, pollution, global warming, making abortion illegal, and con-
servatives. Both parties make a public show of how bitter their con-
licts are, and how dangerous it would be for the other party to achieve
power, while both prostitute themselves to the financial sector, power-
ful industries, and the wealthy. Thus, the very intensity of the two par-
ties’ differences on “values” issues enables them to collaborate when it
comes to money.

Since the 2008 financial crisis, US policy has subsidized banks and
bankers enormously, while extending the Bush administration’s tax
cuts for the wealthy. With their bonuses and their industry restored,
the fake humility of the bankers who begged for government assistance
has now been forgotten. So, unfortunately, has the fact that when the
banks were desperate and dependent in 2008 and 2009, the US gov-
ernment had an unparalleled opportunity to finally bring them under
control—an opportunity that both the Bush and Obama governments
completely wasted and ignored. These same bankers are now among
the first to warn about national deficits, to insist on more tax cuts to
stay competitive, and to warn darkly that any further regulation will
strangle the “innovation” that made them rich, even as it destroyed the
world economy.

But they can be expected to behave that way. Over the last thirty
years, the economic interests of the top 1 percent, who now control the
country’s wealth, businesses, and politics, have diverged sharply from
the rest of us.

The Canopy Economy

Canopy ecosystems are worlds of flora and fauna that occur at the
tops of very tall trees and exist largely apart from the multiple biosys-
tems layered beneath them. They do this in part by getting the best
access to sunlight, but in so doing they block the sun from reaching
everything below.
The vast income accumulated by the narrow slice of super-elite at the top of the wealth pyramid has created a kind of global “canopy economy” that has lost its connections to the nations and people they sprang from. At the very top, the most senior executives, rainmakers, and traders at global banks and corporations routinely pull down eight-figure pay packages. These are people with four or five mansions around the world, yachts, private jet services anywhere at any time, limousines, servants, access, power. They are able to indulge any little personal whim—like Blackstone chief Steve Schwarzman’s penchant for having $400 stone crab legs flown to him wherever he’s on holiday.

The economic impact of this inequality is now astonishingly high. The wealth and power of the new super-elite is both a clue to and a cause of our very tepid recovery from the financial crash. Companies are wallowing in cash, but average workers don’t have money to spend. Labour productivity has improved dramatically, growing in the US by an almost unheard-of 5.4 percent in 2009. So why won’t companies start to hire, and why are average wages declining?

In part, the answer is that the education and skills of the general population are losing two races—one with technological progress, and another with the skill levels of workers in lower-wage nations. Education is the critical variable here. In the Internet age, one can be a high-income, full-employment nation only if most of the workforce has education and skills superior to those available in India, China, and elsewhere at far lower wages.

But another huge reason for the decline of the economy, and of average wages, is the shifting balance of power between the new economic oligarchy, government leaders, and the rest of the population. Investment decisions, wage rates, and government policies are determined largely by people in the canopy economy. This has two very deep consequences.

The first is that well-run, successful companies are indeed investing, but not in people, and not at home. CEOs see far better oppor-
tunities in purchasing information technology systems and in using inexpensive overseas labour.

Large companies such as GE, Boeing, Caterpillar, Ford, and Apple now have, on average, about 60 percent of their sales overseas. (For Intel, it’s 84 percent.) Since the days when Ronald Reagan was its spokesman, GE has seemed like the quintessential American company. But more than half of GE’s employees, revenues, and assets are on distant shores. The heavy equipment manufacturer Caterpillar’s foreign revenues are about 68 percent of its total. Its recent major acquisitions and investments include two engine plants, a backhoe plant, and a mining equipment factory, all in China; an engine plant in Germany, a truck plant in India, and a pump and motor factory in Brazil. Ford, GM, IBM, and almost any other top manufacturing or services company have much the same profile. Of the $2 trillion in cash sitting on American corporate balance sheets, about $1 trillion is actually parked overseas.\(^7\)

GE was a pioneer in outsourcing, starting with data-processing services, using low-cost vendors like India. President Obama’s choice of Jeffrey Immelt, the company’s CEO, to head a new White House economic advisory council in early 2011 came just a few months after Immelt had shut down a string of American lightbulb factories to shift production to China. Like many other firms, GE has also used its global operations to shield income from taxes, helping it to pay no US corporate income taxes for the last several years despite having billions of dollars per year in profits.

Over the last decade, moreover, what is still called “outsourcing” has become something else. The shift to overseas purchasing and investment has spread from low-wage, labour-intensive activities to extremely high-technology, high-skill activities in both manufacturing and services. This development has serious implications for our economic future.

It would probably not surprise many people to learn that most personal computers, laptops, tablets, and smartphones are now manufac-
tured in Asia, not in Silicon Valley, California. However, most of those devices are also now designed in Asia, and by Asian firms, not American ones. The US retains its high-technology lead in advanced research, systems design, software, and systems integration, but has largely lost the capability to design and manufacture information-technology hardware. The employment and competitive implications of this development are profound. For example, Apple has about 70,000 employees worldwide, including its retail stores. But its largest supplier, Foxconn, a Taiwanese company, has 1.3 million employees. The US has already become a net importer of high-technology goods, and high technology actually employs a smaller fraction of the total domestic workforce than it does in many other nations.

But canopy-economy executives don’t care about any of that. They see the whole world not only as their market but also as a source of products, services, labour, and components. For them, the workforce available to nominally “national” companies is much bigger, and much less expensive, than it was ten or twenty years ago. The canopy is a world of calculation: Indian and Chinese workers have much lower living standards than Americans or Britons or Europeans, so they will work for lower wages. Increasingly, many nations also have broadband systems and logistics infrastructure (such as ports, airports, and rail systems) superior to those of the US or UK, if not all of the EU. But it doesn’t make sense for CEOs, either personally or professionally, to lobby for government policies that would improve their national educational or infrastructure systems, particularly if this would also increase their taxes. The benefits of such public investment are society-wide and long-term, not specific to the elite or their companies. And CEOs and bankers have the money and connections to send their children to expensive private schools, to use private jets, to invest their assets globally, and to otherwise avoid the problems of economic decline.

But how did the new financial oligarchy get so amazingly rich, particularly during a period of relatively low economic growth and stagnant income for everyone else? Here we come to the second profound
consequence of the new power structure that rules America and shapes the world.

The full answer involves a series of economic and political processes that began in the 1970s and are the subject of the final part of this book. But in one regard the answer is very clear. With a few major exceptions—most notably high technology—we can say with great confidence that the principal source of the new canopy elite’s wealth was not providing greater value to society. In fact, a significant fraction of our economic decline can be attributed directly to the entrenched power of American executives who destroyed their own industries. Thanks to many excellent studies, some of which I describe in this book, we now know beyond any doubt that for most of the last forty years America’s car, steel, mainframe computer, minicomputer, and telecommunications industries were very incompetently run. Their oblivious and/or self-interested senior management was protected from replacement by complacent boards of directors, lax antitrust policy, political influence, and outdated, ineffective systems of corporate governance.

And then there’s the financial services industry. What do we think of the quality of management in an industry that not only destroys itself but nearly brings down the world economy with it? Do we think that these people deserve great wealth for their achievements? And how about their lobbyists, lawyers, and accountants?

In other words, the new elite has obtained much of its extreme wealth not through superior productivity, but mainly via forced transfers from the rest of the world’s population. These transfers were frequently unethical or sometimes even criminal, and were enormously aided by government policies that reduced taxes on the rich, allowed industrial consolidation through lax antitrust enforcement, protected inefficient firms, impeded protests from trade unions, kept workers’ wages low, permitted massive financial sector frauds, bailed out the financial sector when it collapsed, and shielded corporate crime from law enforcement action. Those government policies were, with varying degrees of subtlety, bought and paid for by their beneficiaries.
In this process, one industry stands above all others: the US financial services. In no other industry has the amorality, destructiveness, and greed of the new elite been so naked. Much of the new wealth of the US financial sector was acquired the old-fashioned way—by stealing it. With each step in the process of deregulation and consolidation, American finance gradually became a quasi-criminal industry, whose behaviour eventually produced a gigantic global Ponzi scheme—the financial bubble that caused the crisis of 2008. It was, literally, the crime of the century, one whose effects will continue to plague the world for many years via America’s economic stagnation and Europe’s debt crisis.

The majority of this book is devoted to describing and explaining this pillaging in considerable detail, but a short overview is in order.

The Greatest Bank Robbery

Although several large, concentrated, and politically powerful industries have benefited enormously from deregulation and political corruption, the 2000s were undeniably the decade of the banker. The era of deregulation pioneered by the administrations of presidents Ronald Reagan and Bill Clinton had removed virtually all restrictions on trading, mergers, and industry consolidation; the few remaining restrictions were then quickly stripped away by the administration of George W. Bush, along with any threat of sanctions from either criminal prosecution or civil suits to recoup illicit gains.

Many steps of the deregulatory process were taken openly, often even proudly, for a majority of academic economists and finance experts were insisting that, once freed from obsolete regulatory constraints, the bankers would allocate the world’s capital flows with such skill and precision as to usher in a new golden age. Many of the professors doubtless believed in their recommendations, although as we shall see later, many of them also were paid handsomely to support the
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And in fact, bad things started to happen almost immediately. Beginning in the 1980s, the US began to experience financial crises and scandals on a scale not seen since the 1920s. But deregulation continued, culminating in major laws passed in 1999 and 2000. Once completely freed, the bankers very quickly ran their institutions off the cliff, taking much of the global economy with them. Not only did they create and sell a huge amount of junk, but they turned the financial system into a gigantic casino, one in which they played mainly with other people’s money. Consider the position of six large banks at the end of 2007—Citigroup, JPMorgan Chase, Goldman Sachs, Lehman Brothers, Bear Stearns, and Merrill Lynch. Their own proprietary trading accounts, in which traders and financial executives were risking their banks’—or more properly, their shareholders’ and bondholders’—money for their own profit, were in excess of $2 trillion. Indeed, their assets had grown by $500 billion in 2007 alone, almost all of it financed with borrowed money.

Leverage—the use of borrowed money to expand the investment banks’ businesses—roughly doubled between 2000 and 2007. Three of the largest banks—Lehman Brothers, Bear Stearns, and Merrill Lynch—were leveraged at more than thirty to one at year-end 2007. This meant that only 3 percent of their assets, many of which were very risky or even fraudulent, were paid for with their own money. This also meant that a mere 3 percent decline in the value of their assets would wipe out all of their shareholders’ wealth and throw these firms into bankruptcy. And, indeed, by early 2008 Bear Stearns was within days of bankruptcy and sold itself to JPMorgan; in September, Merrill sold itself to Bank of America, and Lehman Brothers went bankrupt. Many others failed too—Countrywide, New Century, Washington Mutual—and other even larger institutions, such as Citigroup and AIG, survived.
only by virtue of massive bailouts. Even Goldman Sachs, one of the strongest of the banks, could not have survived if the government had not saved AIG, and then forced AIG to pay its debts to Goldman and other major banks.

How could so many bankers be so reckless? Money and impunity, is the answer. The structure of personal compensation in the financial system had become completely toxic, and bankers correctly assumed that they would not be prosecuted, no matter how outrageous their conduct. Until the 1980s a combination of tradition, reputation, and tight regulation governed bankers’ compensation and prevented major systemic abuses. For example, investment banks were structured as partnerships, with the partners required to invest their own personal money, which constituted the firm’s entire capital. In fact, until 1971, only partnerships were allowed to join the New York Stock Exchange.

But starting in the 1980s, all that began to change, and by the 2000s, both the structure of the financial sector and its compensation practices would have been unrecognizable to a banker of 1975. At every level from individual traders to CEOs to boards of directors to transactions between firms, people and companies were now rewarded immediately (and usually in cash) for producing short-term profits, with no corresponding penalties for producing subsequent losses. This was fatal. In finance, it is extremely easy to create transactions that are initially profitable, but are disastrous failures in the longer term. But by the 2000s, the bankers didn’t have to give any money back if that happened, so they didn’t care. In fact, they were actively incented to be destructive—to their customers, to their industry, to the wider economy, even frequently to their own firms.

While the party lasted, it made banking look like paradise. During the bubble of the 2000s, financial sector profits soared to nearly 40 percent of all US corporate profits. The average pay of people working at US investment banks jumped from about $225,000—already an amazingly high number—to over $375,000, where it has stayed, even after
the crisis. And that was just the cash; those numbers do not include stock options.

And that’s the average. Consider what happened to the pay of “named executive officers”, or NEOs, the highest-paid senior officers (although in any given year, the hottest traders may make more). According to their 2008 proxy statement, the top five officers at Goldman Sachs averaged $61 million each in compensation in 2007. Pay levels like that disorient moral compasses; so did the private lifts, the private jets, the partners’ private dining rooms and personal chefs, the helicopters, the cocaine, the strip clubs, the prostitutes, the trophy wives, the mansions, the servants, the White House state dinners, the fawning politicians and charities, and the multimillion-dollar parties. There is no denying that in chasing all these things, many bankers not only destroyed the world economy but also sabotaged their own institutions and, in some cases, even themselves.

Nor has financial sector compensation changed greatly since the crisis. In 2008, when all banks were gasping for their last breath, the average NEO compensation dropped back only to the 2005 level, and in January 2009, in the depths of the crisis that they had caused, the New York investment banks awarded their employees over $18 billion in cash bonuses.

But the banks are also guilty of two other, even larger, crimes. The first of these is that they used their wealth to acquire and manipulate political power, to their own advantage but to our enormous, long-term detriment. It was in large measure the financial sector’s political activities (through lobbying, campaign contributions, and revolving-door hiring) that gave us deregulation, abdication of white-collar law enforcement, tax cuts for the wealthy, huge budget deficits, and other toxic policies.

And the bankers’ final crime was that, far from channelling funds into productive uses, the financial sector has become parasitic and dangerous—a semicriminal industry that is a drag on the American economy. The banks have destabilized the financial system, wasted
huge sums of money, plunged millions of people into chronic poverty, and crippled economic growth throughout the industrialized world for many years to come. The proper job of bankers is to allocate capital efficiently by assembling savings from households and businesses, and to place that money into the investments that produce the highest long-term returns for the economy. That is how the financial sector creates jobs and prosperity—or so economic theory says it should.

But the housing boom of the 2000s, which was based on a combination of unsustainable consumption and outright fraud, brought no real economic improvement. The financial system deliberately shifted its focus toward people who were either bad credit risks or easy victims, creating new products to entice and defraud them.

By the autumn of 2005, Merrill Lynch estimated that half of all US economic growth was related to housing—including new construction, home sales, furniture, and appliances. Much of the rest came from the Bush administration’s enormous deficit spending. America was living in a fake economy. Finally, in 2008 the banks ran out of victims, and the bubble collapsed.

None of the financial destruction wreaked by the bankers was an act of God. Nor was it unforeseen. Voices were raised in warning early in the 2000s, and in greater and greater volume, as the bankers plunged into ever more exotic universes of risk. Some of them are in my film Inside Job—Raghuram (Raghu) Rajan, Charles Morris, Nouriel Roubini, Simon Johnson, Gillian Tett, William Ackman, Robert Gnaizda, the IMF, even the FBI. They were all ignored, even ridiculed, by those who were profiting from the situation. To a great degree, of course, the outlines of this story are now known, and I will spend relatively little time on it. Most of this book is therefore devoted to two issues: first, the rise of finance as a criminalized, rogue industry, including the role of this criminality in causing the crisis; and second, an analysis of the wider growth of inequality in America.
The book therefore proceeds as follows: Chapter 2 offers a short history of the twenty-year period that led to the rise of a deregulated, concentrated, destabilizing financial sector, including the reemergence of financial crises and criminality.

Next, I describe the available evidence about banking behaviour during the 2000s, including the role played by criminal behaviour in the bubble and crisis. Chapter 3 examines mortgage lending; chapter 4, investment banking and related activities; chapter 5, the coming of the crisis and the behaviour it produced. Chapter 6 surveys the rise of financial criminality, and the case for criminal prosecutions. Not all of the bankers’ actions were criminal, of course, but some were—especially if we apply the same standards that sent hundreds of savings and loan executives to prison in the 1990s, not to mention what happened to people not lucky enough to be working for major investment banks when they committed fraud or laundered criminal money.

The last four chapters of the book are a wider analysis of America’s recent changes. Starting with financial services, and then turning to academia, other economic sectors, and the political system, I discuss America’s descent over the last generation into an economically stagnant, financially unstable, highly unequal society. I begin in chapter 6 by examining the financial sector’s transformation into a parasitic industry that increasingly confiscates, rather than creates, national wealth.

In chapter 8, I turn to academia. Many viewers of Inside Job commented that the most surprising and shocking element of the film was its revelations about academic conflicts of interest. Here I provide a far more detailed and extensive examination of how the financial sector and other wealthy interest groups have corrupted American academia, changing its role from independent analysis to an additional tool for corporate and financial lobbying. In chapter 9, I consider the broader decline of the economic and political systems. Chapter 10 concludes the book with a discussion of the alternative futures facing the US and Europe, the large-scale policy changes required to reverse Ameri-
can decline, and finally the potential avenues for achieving these ends through social and political action.

This last task will not be easy. The conduct of the Obama administration provides a painfully clear example. For reasons described in the final chapters of this book, a political duopoly is now highly entrenched in the US and it is resistant to change. Despite their populist pretensions, both American parties depend on the money that flows to them because they, and only they, control electoral politics, and both parties would fiercely resist any challenge to this arrangement.

And there is a final problem. To some extent, it must sadly be admitted, this decline has been tolerated by the American people. Over the last thirty years Americans have become less educated, less inclined to save and invest for the future, and, understandably, far more cynical about participating in politics and other institutions. Consequently, it has proven disturbingly easy for the new oligarchy to manipulate large segments of the population into tolerating, even supporting, policies that worsen the world’s economy. And, of course, many young people have simply given up on politics, particularly after numerous betrayals, including by the Obama administration; many are now profoundly disturbed that Obama turned out to be more of the same.

To reverse this decline, it will first be necessary to reverse the consolidation of economic power now wielded by highly concentrated industries, the financial sector, and the extremely wealthy. In addition, it will be necessary to shift economic priorities towards education, saving, and long-term investment, and away from excessive reliance on cheap energy and, in the case of the US, military power. And finally, it will be necessary to profoundly change the role of money in politics—in campaign contributions, political advertising, revolving-door hiring, lobbying, and the enormous disparities between public and private sector salaries that have taken over the American system and threaten to take hold elsewhere.

There are three alternative routes for achieving deep systemic reform, both in the US and farther afield: a successful insurgency in one of the existing political parties; a true third-party effort; and a nonpar-
tisan social movement perhaps analogous to the civil rights or environmental movements of a generation ago. All of these paths are difficult. But we have done difficult things before, even when they faced powerful opposition. Often the most remarkable achievements come in part because of remarkable leaders who have been committed to remarkable goals. Let us hope we see such leaders again.