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Inside Job

The Financiers Who Pulled Off the Heist of the Century

Written by Charles Ferguson

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The Financiers Who Pulled Off the Heist of the Century

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INSIDE JOB

CHAPTER 1

WHERE WE ARE NOW

MANY 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 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 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 confined 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 skilfully exploit America's cultural polarization. Republicans warn social conservatives about the dangers of secularism, taxes, abortion, welfare, gay marriage, gun control, and liberals. Democrats warn social liberals about the dangers of guns, pollution, global warming, making abortion illegal, and conservatives. Both parties make a public show of how bitter their conflicts are, and how dangerous it would be for the other party to achieve power, while both prostitute themselves to the financial sector, powerful industries, and the wealthy. Thus, the very intensity of the two parties' 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 government 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 biosystems 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.