



**After *Inside Job*:  
consequences, problems and perspectives**

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**Debating Innovation 2012 Vol. 2(1): 25-32**

## **After *Inside Job*: consequences, problems and perspectives**

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### **Abstract**

Charles Ferguson is the director of *Inside Job* (2010, Sony Pictures Classics), a widely acclaimed documentary film on the financial crisis of the late 2000s. The film has received a number of awards, including the Academy Award for Best Documentary Feature in 2011, and has also contributed greatly to the public understanding and the public criticism of the practices that led to the global financial debacle which started in 2007. The film focuses on the booming of financial innovation from the late 1990s onwards (securitization of subprime loans, development of credit derivatives) in the North-American financial services industry, on regulatory liberalization, and on the lack of accountability and the systematic corruption that characterized the activities of most dominant actors during that period. In this conversation with Fabian Muniesa, a member of the Observatory for Responsible Innovation, Charles Ferguson reflects on the consequences of *Inside Job* and on the crucial responsibilities and issues that still need to be addressed. The interview was carried out on October 4, 2011. Further information about *Inside Job* is available at [www.insidejobfilm.com](http://www.insidejobfilm.com). A companion book to the film with further materials and analyses is forthcoming (2012, Crown Business).

**FM (Fabian Muniesa):** One crucial question that needs to be asked today is the part played by financial innovation in financial catastrophes. This is a controversial topic that has been now addressed to some extent in the literature. We are starting to know more about the negative externalities and unforeseen perils of innovation in a variety of areas, including finance.

**CF (Charles Ferguson):** I particularly recommend in this respect Richard Bookstaber's book, *A Demon of Our Own Design* (John Wiley & Sons, 2007). The book is very interesting, and is precisely about that. Bookstaber looks at various financial crises caused, at least in part, by financial innovation. He compares them to other critical events in non-financial areas: he examines for example the case of the Three Mile Island nuclear power plant accident of 1979. These kinds of comparisons are necessary to understand the problems of innovation in the financial services industry.

**FM:** Were those the kind of alternative views of finance that informed *Inside Job*?

**CF:** Yes. We actually interviewed Richard Bookstaber. That was a very rich conversation that was not added to the film for technical reasons but that was very important for us. We also counted on the insights of authors such as Nuriel Roubini and Gillian Tett, for example.

**FM:** One thing *Inside Job* does is to make financial innovation discussable within the public space. In other words, it makes finance arguable and debatable. This is a hard task because discussion on the rationales and consequences of financial innovation is usually restricted to circles of financial expertise and rarely open to democratic debate. *Inside Job* is, in part, about debunking political rationales behind financial innovation. But it is also, perhaps more importantly, about questioning the legitimacy of mainstream financial expertise and mainstream financial economics. Do you share this reading of your work?

**CF:** I think this is a fair reading. One thing that struck me in the course of doing research for the film, and also in the course of interviewing many people for the film, was the fraction of financial innovation - with "innovation" in quotation marks - over the last quarter century that has apparently not been for productive purposes but rather for the purpose of avoiding various forms of regulatory or legal control, avoiding taxes, avoiding European Union regulation with regard to national budgets deficits, avoiding capital requirements and leverage limits for financial institutions, making things that should be taxable non-taxable, taking off balance sheets things that should be on balance sheets, and so forth. One thing many of the people we interviewed for *Inside Job* said was that, of course, there are legitimate and valuable financial innovations. People pointed to two particular cases very frequently. One was microfinance and the other was the venture capital system in the United States. These are innovations that seem to be socially productive. But, people said, look in contrast with the reasons why these other various forms of credit derivatives, these various forms of transactions were developed. A very high fraction of the motivation was either about enabling some form of gambling that otherwise might not be legal, or in other cases about avoiding some kind of regulatory constraint, whether it's capital requirements or taxes or regulatory controls. It was important to make that point in the film, but also to address the question of the legitimacy of experts, firstly with regard to how much economists really know about these things and therefore to how risky it might be to rely on their predictions, and secondly, and perhaps more importantly in my view, with regard to the fact that expertise is compromised by the financial conflicts of interest that many of these economists do face - they are not independent experts.

**FM:** *Inside Job* was quite effective in that task. The film provides quite shocking insights on prominent advocates of neoclassical views on financial innovation, their financial ties with the industry and the responsibility of the higher education institutions they work for. People got worried. Relevant universities that were pointed to in the film got severely affected. Your work had quite some social and political efficacy in that area. The issue of the accountability of academics was raised. Do you have a reflection on that?

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**CF:** The film has had an effect on the academic word with regard to these questions. I do not think it is a sufficient effect. The response has not been sufficient to eliminate the problem. But there has been a response, in a good direction. A number of universities, in response to the film, held public meetings and conferences of various kinds about the accountability of economists, a couple of which I attended - there was one at Columbia University, another one at Stanford University. And a number of universities tightened their conflict of interest regulations and disclosure requirements. I do not think many of them have gone far enough. Stanford has gone through the most satisfactory achievements, and was also in a good position when the film came out. I do not think that the regulations of most other universities are sufficiently adequate. But there has been improvement, very noticeable improvement. And I also think that, beyond regulations, there is an increased awareness among students and the media. And I have noticed recently a different attitude towards academics in several articles in *The New York Times* and other prominent media. It is not taken for granted that they are objective. And sometimes conflicts of interest are actually pointed out in the article. That is a big step forward. I am actually very proud of what the film has done in this regard.

**FM:** So there is an effect on academics. But there are also bankers and regulators. Do you have a hint on the impact of *Inside Job* in these areas?

**CF:** I think that a lot of them already knew about this. But probably many of them did not understand how serious it was. I do not have a good sense of what the effect has been in those domains. But I think there has been some effect. Take congressional staff members for example, who are evaluating who should testify in Congress: my guess is that they did not understand how pervasive this was and now they are a little more careful.

**FM:** Financiers that were at the heart of the crisis and that today can take some distance with the financial services industry can react to accounts such as the one given in *Inside Job* claiming: yes, this is our story, we are glad that it can be spoken about now, we surely had a part of responsibility in what happened, but regulators are also to blame since they failed to do their job. Regulators, on the other hand, are able to recognize aspects of regulatory failure, but will tend to direct responsibility rather to bankers and their profit-seeking financial imagination. What do you think of this interplay of responsibility?

**CF:** I do not know any way to evaluate the exact relative responsibility of bankers and regulators. Both groups bare a lot of responsibility, for sure. And also, by the way, in the United States at least, it has become more and more difficult to tell the two apart. A very high fraction of regulators in the United States are former bankers. And many regulators, whether or not they were already former bankers, go into the banking system after they have spent in regulatory institutions. Peter Orszag, who was Director of the Office of Management and Budget in the Obama Administration for two years, resigned and became Vice Chairman of

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Global Banking at Citigroup. If you look at the people who are running the Obama Administration now - and it was largely true also in the Bush Administration and even of the Clinton Administration - an important fraction of them are former bankers, bankers of some kind, either in hedge funds or commercial banks. The current Deputy Secretary of the Treasury, Neal Wolin, ran an insurance company. Timothy Geithner, the current Secretary of the Treasury, is actually one of the few who has not been a "real" banker. Before, he was the President of the Federal Reserve Bank of New York. The regional Federal Reserve Banks in the United States, and this is not a widely known fact, are private institutions which are run by private-sector banks. The president of the Federal Reserve Bank of New York is chosen by a bunch of bankers, not appointed by the President. So Tim Geithner was sort of in the private sector. But he was not a "real" banker. He was actually one of the very few who was not. Almost everybody else had worked very directly for the financial sector, including, by the way, Larry Summers. Even when he was president of Harvard University he had a one-day-a-week job working in a hedge fund, D. E. Shaw & Co., a hedge fund that was heavily involved in mortgage securitization products and investment in distressed securities. So today it is quite difficult to say who is a regulator and who is a banker.

**FM:** Let us suppose that some bankers and regulators learned a little bit from the crisis, and eventually from your work. Let us also suppose that there is a collective engagement towards financial stability and a shared exploration of solutions towards a more responsible financial services industry. Several possible measures are discussed in the media, in policy circles and in the social sciences: focus on incentives and restraint in trading behavior, focus on control of sophisticated products, focus on precautionary capital requirements, and so forth. Do you have a preferred direction among the several possible responses to the current crisis?

**CF:** There is a long list of those specific policy measures. I do believe in a lot of them. I think that something needs to be done about the rating agencies. I do also believe that the financial sector in the United States should be less concentrated, and that some of the larger financial institutions should be broken up. I do believe that the structure of compensation in the financial sector should be regulated. But I think that there are two other things that are particularly important and more fundamental now, at least in the context of the United States, and unless those more fundamental things are fixed I think one can be skeptical about the efficacy of any long-term solution. One of these fundamental problems is the role money plays in politics in the United States, which has changed greatly over the last thirty years. I myself had already understood that there had been a big change, but when I looked at the data about this I was really stunned about how big the change had been. In 1976, all candidates for the presidency of the United States spent, together, about 66 million dollars in the presidential election. In the forthcoming presidential election, combined total expenditures are expected to be in the neighborhood of 2 billion dollars. So, from 66 million dollars to 2 billion dollars, that is a very big change. And there are been similar changes in a number of other arenas, some of which I think are just as important.

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**FM:** Which are?

**CF:** One of them, for example, is private-sector vs. regulatory salaries. The difference between the income of a regulator and the income of somebody who is a banker or a lobbyist or a lawyer in a law firm was perhaps considerable thirty years ago, but it was almost irrelevant: a 30, 40, 50 percent difference. But now the difference is a factor of 10, a factor of 20. It is just huge. And, also, many things that educated people care about have become radically more expensive in the United States. In particular, the cost of sending your children to a good private university is now dramatically higher than it used to be. And so is the cost of health care and health insurance, but the main issue is education. So if you are a civil service regulator at a very high level, or a presidential appointee like the Secretary of the Treasury, your salary is about 200,000 dollars a year. It is a comfortable living. But if you have two or three children and you want to send them to a private university, well, it can become problematic. When I started graduate school at MIT, tuition at MIT was 4,700 dollars per year. In 2011, it's 42,000 dollars. And that is just tuition, not living, eating or buying books. So that means it really costs like 60,000 dollars a year to send your kid to MIT. This means about a quarter million dollars for the entire graduate program. And if you have three kids, then it costs almost one million dollars to send them to MIT. And that does not count the fact that today many people think that they have to send their children to private high schools, which are almost as expensive. So, if you have two or three children and you want to give them a good education, you have to come up with a million dollars. And you cannot do that with a public-sector salary, you just can't. People feel this intense pressure to move to the private sector. And if you are a regulator the easiest way to do that is... well, you see how it works.

**FM:** This is a crucial issue in your opinion.

**CF:** There are many issues. But the role money has come to play in politics has changed dramatically, and so has changed the role money plays in the professional career of regulators. And that is one thing that surely needs to be fixed. But there is a second crucial issue that I would like to emphasize. Somehow, white-collar law enforcement needs to be strengthened. Twenty-five or thirty years ago, when these things would happen, it used to be that people went to jail for it. And they do not anymore. Nobody is going to jail. Nobody is prosecuted for their behavior. You can debate how much criminality there was in the financial crisis of the late 2000s, and what fraction of the crisis was caused by criminal behavior. But it is not zero. It is not. It is very clear that there was quite a lot of criminality, in some cases at very high levels. I think people's conduct would be different if they realized they could go to jail.

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**FM:** So those two aspects, the financial pressure on political and regulatory life on the one hand and the lack of criminal procedure on the other, may be more fundamental than specific lists of policy recommendations.

**CF:** I do believe that. Of course, I believe also in the regulation of compensation in the financial sector and on increased capital requirements. I also think that derivatives should be more transparent, traded on exchanges. All those things are important. But I fear that, unless something is done in the United States about the more fundamental causes of the problem, ten or fifteen years from now this will happen again.

**FM:** In a sense, these issues are about the distribution of income in society and the power of financial professionals. Recent protest movements, such as Occupy Wall Street, seem to put these issues upfront.

**CF:** Many people, including myself, have been very surprised at the lack of political and social protest as a result of the crisis and the recession, and then also as a result of the Obama Administration policies. I think that, now that the recovery is faltering and people are once again worried about the behavior of the economy, there is a chance that there finally will be some significant social and political protest and action, which in general I would be in favor of.

**FM:** Do you also perceive a comparable concern within the financial services industry, especially in the midst of the current European debt crisis?

**CF:** There should be a concern: concern about the idea that the way to take care of the problem is by inventing some clever financial fix, as opposed to really taking care of the problem itself. I have spoken to a lot of people who are tackling the European debt crisis, who are either observing it as economists or working on it as bankers and regulators. And, at least in private conversation, they are extremely concerned about the situation. None of them think that the current way that the problem has been handled is going to prove adequate. They are all concerned that there are no sufficiently clear and straightforward legal and political mechanisms to contain the problem and to enforce solutions in a coordinate manner.

**FM:** You say that regulators, economists and bankers tend to express concern privately. Is not that a problem, that debates and arguments are rarely spelled out publicly?

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**CF:** Some of them speak out. Some others cannot. The Chief Financial Officer of a very large European bank is obviously constrained on what he can say in public. The same happens to members of European institutions, who have to be very careful about what they claim publicly. But my impression is that they are speaking among themselves, which is good. I think there is a pretty direct, open debate going on now in the financial and regulatory community, and this is something that needs to be acknowledged.

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