

## Economists' Forum

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### The economist's reply to the "Inside Job"

October 8, 2010 4:13 pm by Financial Times

*By Prof Frederic Mishkin*

"You ought to be in pictures" is something no one has ever said to me. And as one of a number of economists making uncomfortable cameo appearances in the new Hollywood documentary, "Inside Job," I now know why.

In July 2009, I agreed to be interviewed on camera for a film that was presented to me as a thoughtful examination of the factors leading up to the 2008 global economic collapse. About five minutes after the microphone was clipped to my lapel, however, it became clear that my role in the film was predetermined – and I would not be wearing a white hat.

Rather than examining the facts of the financial crisis, the filmmaker focused on a study I co-authored that was commissioned and published by the Icelandic Chamber of Commerce in May 2006. The report, which I welcome people to read, examined a variety of risks to Iceland's financial stability about 28 months before its financial crisis hit.

It would be great to be able to say that I predicted the collapse of Iceland's economy more than two years before it happened, but I didn't. However, my co-author and I did correctly identify several risks to Iceland, including rapid credit growth, a lack of transparency in the banking system, and the possibility that banks could experience refinancing problems. And many of the excesses of the Icelandic banks that led to their collapse had yet to emerge at the time the report was written. For example:

- The Icelandic banking system was only 40% of the size it reached just before its collapse in October 2008.
- Deposit accounts abroad such as the Icesave accounts (particularly in the U.K. and Holland), which have led to demands for large sums of repayment from foreign government after the crisis, did not yet exist, and were first issued in Autumn of 2006 in the U.K. and summer of 2008 in Holland.
- The investment grade of the Icelandic banks was excellent at the time of publication of the report. In 2007 their investment grades were raised even further. The banks were not downgraded until the summer of 2008.

- Mortgage and other loans denominated in foreign currencies were not prevalent until later.

I would have been pleased to discuss these later developments in Iceland's economy in more detail with the filmmaker – had he given me a chance. We might have also discussed why the financial crisis occurred, and why policymakers and the economics profession (myself included) did not fully recognize the inadequacies of prudential regulation and supervision of the financial system in advanced economies. Instead, the filmmaker made insinuations that I didn't disclose that I was compensated for the study – even though he learned the precise amount of the fee in a 2006 from a public disclosure that I made. Even odder, a big deal was made of an inconsistency in my curriculum vita, where the title of the Iceland study first appeared in 2006 with the phrase “Financial Instability” and later as “Financial Stability” (the accurate language). I had discovered and corrected this typo long before the interview.

Hopefully, interviews like the one I experienced will not dissuade economists and academics from participating in the important public discourse needed to better understand what went wrong during this crisis, and how to bolster prudential regulation and supervision of the financial system to make severe worldwide financial crises less likely.

Academic economists (myself included) did get some things right in the run up to the crisis. Many of us identified Fannie Mae and Freddie Mac as accidents waiting to happen long before they saddled American taxpayers with losses that are now estimated to total between \$400bn and \$1,000bn. Of course, we in the economics profession need to recognize where our theories and empirical research proved inadequate, and then revise them to provide better analysis to guide economic policy in the future.

This is the sort of work that I'll be focusing on for now. It's all too clear I have no future on the silver screen.

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