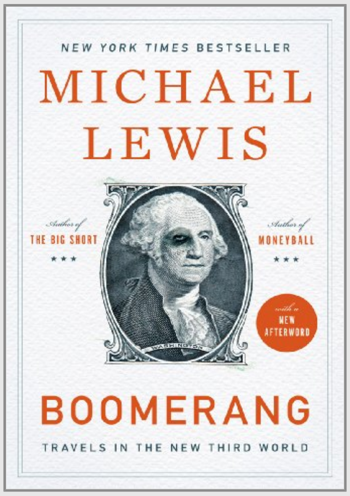

Boomerang

Travels in the New Third World

Michael Lewis
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240 pages
Book: getab.li/22959

Rating

9

7 Importance
8 Innovation
10 Style

Focus

Leadership & Management
Strategy
Sales & Marketing
Finance
Human Resources
IT, Production & Logistics
Career & Self-Development
Small Business
Economics & Politics
Industries
Global Business
Concepts & Trends

Take-Aways

- American investment banks convinced Iceland to finance purchases with borrowed foreign currencies; when Iceland's economic bubble burst, crisis followed.
- Real estate became the best place for Greeks to hide their assets, because the country "has no…national land registry."
- No one knows how much debt built up as a result of Greece's financial meltdown.
- The Greek political system torpedoed its financial system, not the other way around.
- The Anglo Irish Bank bled at least €34 billion from the Irish economy.
- When Ireland's housing bubble burst, the country's economy went from rich to very poor.
- The European Central Bank rescued Ireland to the tune of nearly €100 billion.
- Germany handled its own economy responsibly, but German banks invested unwisely abroad and lost billions.
- Some US state and municipal governments – in deep financial crisis – cannot pay for services or fund pension plans.
- The US's fiscal dilemma results from shortsightedness and selfishness.

Relevance

What You Will Learn
In this summary, you will learn: 1) How Iceland, Ireland and Greece tumbled into crisis during the financial meltdown of 2008; 2) What role Germany played in the euro zone's recovery as of 2011; and 3) How US state and local governments faced their own economic crises.

Review
As the euro zone grapples with the repercussions of the 2008 financial crisis – with debtor nations jockeying to end austerity and powerhouse Germany unwilling to bend – financial journalist and expert wordsmith Michael Lewis looks back to see how it all began. His 2011 tours through Iceland, Ireland, Greece and Germany throw helpful, entertaining illumination on the irresponsible – or out-and-out strange – behavior that got Europe into such a lasting jam. Lewis's wry and highly readable travelogue hinges on individual stories and features Europeans' memorable expressions of disgust, defiance and sheepishness. His visit to suburban California at the end of the book will disturb your sleep for months to come. There is one comfort: You will thoroughly enjoy how well Lewis writes. *getAbstract* recommends his bestseller to anyone concerned about the world's future financial health. Revisit the start of the meltdown, and see how far (or not) the world economy has come.

Summary

Iceland's Meltdown
Iceland became a surprise entrant into the economic bubble that burst spectacularly in 2008. Iceland's banks held only a few billion dollars in 2003, but by 2006-2007, their assets rose to nearly $150 billion, many times higher than the nation's gross domestic product. This increase marked, "the most rapid expansion of a banking system in the history of mankind." When the worldwide financial meltdown began, Iceland's banks lost "$100 billion," which was "roughly $330,000" for each citizen. The banks racked up liabilities equaling 850% of the country's GDP.

"Iceland is no longer a country. It is a hedge fund."

Before 2008, Iceland's economy soared as the value of its currency, the krona, increased. Icelanders made the fatal error of borrowing in foreign currencies, which carried lower interest rates, to finance their purchases. This worked fine as long as the krona kept rising. When the housing bubble popped and the krona fell, Icelanders' repayments inflated, leaving them with "$500,000 houses with $1.5 million mortgages." The nation's dependence on imports meant more domestic spending, with a devalued currency, just to survive. This further damaged Iceland's economy.

The entire episode is completely out of sync with the Icelandic national character. Until American investment titans Morgan Stanley and Goldman Sachs convinced Iceland's bankers to invest in businesses using foreign money, thus spurring its citizens to gobble up consumer goods, Icelanders had no inkling of "what investment banks did" and could not foresee the ramifications of their own behavior. The supposed profitability of their investments proved a sham: "They created fake capital by trading assets amongst themselves at inflated values."

"Overnight, Iceland had its first billionaires, and they were all fishermen."

Experts expressed caution. Representatives of Danske Bank in Denmark published a 2006 prospectus warning their clients to avoid any Icelandic investing. The unchecked growth of

Iceland's financial sector, they said, would end in ruin. The Icelandic government at the time disputed the report and accused the Danes of economic envy. When University of Chicago economist Bob Aliber tried to warn that Iceland was a "giant bubble," Icelandic financiers tried to suppress his speech. Several European banks continued to invest billions in Iceland.

"One of the distinctive traits about Iceland's disaster, and Wall Street's, is how little women had to do with it."

The global financial meltdown began with Lehman Brothers' failure in September 2008. When the crisis hit Iceland, its political leaders blamed not themselves but "foreigners" who "demanded their capital back." In the past, Iceland's government managed its resources much more responsibly, placing catch quotas, for example, on the country's crucial fishing industry. This regulation made some Icelanders wealthy and encouraged the government to securitize the country's other "main natural resource: energy."

After taking these industries to their greatest profitability, Iceland tried to discern what enterprise would be next. The answer, with dire consequences, was investment banking. No one stopped the predominantly male Icelandic financial sector from plunging the country into economic doom.

Greece

"The Greek state was not just corrupt but also corrupting."

The country of Greece had the most unusual response to "the tsunami of cheap credit" that world economies enjoyed in the early 2000s: No one tracked the true amount of the nation's burgeoning debt. Greece turned itself "into a piñata stuffed with fantastic sums" and invited everyone to "whack at it." Government hiring and salaries, as well as bribery and thievery, skyrocketed. When Greece adopted the euro, for instance, the government moved major debts "off the books" to meet the European Union's budget-deficit requirements.

Greece met with disaster not because its banks behaved like American subprime lenders but because the banks had "lent roughly 30 billion euros to the…government," which was utterly corrupt. The political system torpedoed the financial system, instead of the other way around.

"Even in an era when capitalists went out of their way to destroy capitalism, the Irish bankers had set some kind of record for destruction."

The problem of tax collection compounded the dreadful situation. Tax nonpayment and fraud are rampant in Greece, where the courts of law resolve cases at a painfully slow pace. Real estate became the best place for Greeks to hide their assets, since the country "has no…national land registry." During the bubble, Greece overestimated its property values by using "phony" reported sale prices.

Since the tax system enables widespread cheating and the government runs on bribery, Greece entered a surreal state in which no one in the country trusts anyone else. "The epidemic of lying and cheating and stealing," in fact, "makes any sort of civic life impossible." The nation is in a state of "total moral collapse."

Ireland's "real estate boom had the flavor of a family lie: It was sustainable so long as it went unquestioned and it went unquestioned so long as it appeared sustainable."

The Vatopaidi monastery presents a microcosm of how Greeks violated their own economic system. The monks in this 1,000-year-old complex sparked a national scandal when they traded a lake, a former nature preserve whose deed they owned, for higher-priced federal land, which they intended to rent out to create their own "commercial real estate empire." The Greek government filed suit against the monks. But prosecutors could never figure out the actual amount of the monastery's true assets.

The scandal preceded Greek demonstrations against corruption and the imposition of austerity measures designed to pull the country out of its tailspin. Protests, strikes and other organized acts of civil disobedience "effectively shut down the country."

"Conceived as a tool for integrating Germany with Europe…the euro had become the opposite. For better or worse, the Germans now control the financial fate of Europe."

"When you borrow a lot of money to create a false prosperity, you import the future into the present."

"Other countries used foreign money to fuel various forms of insanity. The Germans, through their bankers, used their own money to enable foreigners to behave insanely."

"It was left to the Germans to act as a moral arbiter, to decide which financial behavior would be tolerated and which would not."

Ireland

The Anglo Irish Bank proved the main culprit in Ireland's meltdown. The government claims the bank bled €34 billion from the Irish economy, while experts labeled Ireland as even more reckless than Iceland. The severe fallout amounted to the breakdown of the country's economy, with unemployment increasing to 10% and a deficit increasing to "32% of its GDP." Strangely, the catastrophe did not immediately lead to a change in government. Instead, foreign regulators and experts rushed in to prop up the situation.

These regulators face a Herculean task. Ireland has gone from being near the top of the list of the world's richest countries to being one of its poorest. Observers suggest that the removal of trade barriers and the imposition of negligible corporate taxes – to name but two problems – bear much of the blame. Others believe that a distinct decline in births was also a factor. Economists still cannot agree on all the causes, but even so the Irish housing bubble carries primary responsibility for the nation's fiscal woes. It ballooned so large that, had it continued, it "implied an economic growth rate that would leave Ireland…three times as rich as the United States." The bubble continued unabated, even though exports were down and the Irish were building homes only for other Irish citizens.

Morgan Kelly, who taught economics at the University College Dublin, publicly warned that when the bubble burst, Irish banks would have to cover enormous losses. That the Irish banks' primary funding source was overseas money only made the problem worse. The September 2008 meltdown revealed that Ireland's economy was mostly a "giant Ponzi scheme."

Although Merrill Lynch originally claimed that "all of the Irish banks are profitable" – a report it later recanted – events soon proved that Professor Kelly's warnings were valid. In the aftermath, in contrast to the United States, bankers in Ireland became national pariahs, partly because Irish law does not allow homeowners to abandon their mortgages – also unlike the law in the US.

To forestall a complete catastrophe, the European Central Bank stepped in with loans of €97 billion. Private bondholders found themselves stuck with the bill. Eventually, the Irish government took over the Anglo Irish bank in January 2009 and later created its own version of America's TARP, the National Asset Management Agency. At the time, unfinished construction projects and uninhabited homes festooned the Irish countryside. But unlike Greece, Ireland saw few angry demonstrations.

Germany

Germany functions as "the biggest creditor" of the wounded European countries staggering under the weight of the financial crisis. The world watches to see if Germany – with its unscathed economy – will bail out its neighbors. Germany's patience is short, however, particularly with Greece, which Germany believes performs poorly on tax reform and other structural issues.

Driving German discontent is the fact that Germany joined the euro zone only on the assurance that it would never have to come to its neighbors' economic rescue. Additionally, Germany hews closely to the European Central Bank rule that it "cannot accept as collateral bonds classified by the US rating agencies as in default."

The situation feels unsolvable: If Greece defaults, it could drive "other European countries and their banks" into default as well. Meanwhile, to avoid future disasters, Germany insists that debtor nations must behave with the same fiscal probity as Germany manifests. The prospects of that happening seem unpromising; Germany's role in the crisis remains complex. Germans did not indulge in bad economic behavior before the 2008 crisis. But German banks made it possible for countries like Iceland and Ireland to dig themselves into massive debt by funding nearly $200 billion in US subprime-backed bonds. These huge shortfalls lead some to believe that the German government seeks to camouflage its guilt by funding the same entities that must pay it back, instead of allowing those parties' mismanaged banks to fail.

"It's not just a coincidence that the debts of cities and states spun out of control at the same time as the debts of individual Americans."

The German financial sector suffered shock at its losses and deep embarrassment that its banks adopted irresponsible "American" lending practices. Germans feel chagrin that German investors fell prey to Wall Street denizens who convinced them to make bad loans. To take one egregious example, IKB, in Düsseldorf, lost a minimum of $15 billion. Even as markets melted down in 2007, German banks continued to invest. "The Germans proved especially vulnerable to a false idea…that there is such a thing as a riskless asset."

The United States

In the aftermath of the 2008 meltdown, market forecaster Meredith Whitney investigated how much US state and local governments owed their creditors, including retirees who expected pensions. Her public warning about an impending "crisis in local finances" caused an immediate crash in municipal bonds. She "had found the pressure point in American finance: the fear that American cities would not pay back the money they had borrowed." Analysts called her knowledge and reputation into question, but Whitney proved correct: In five years, US states built up debts approaching "nearly $1.5 trillion." Whitney analyzed several states and found that California faced the most peril.

"The relationship between the people and their money in California is such that you can pluck almost any city at random and enter a crisis."

Prior to the financial crisis, California voters rejected then-Governor Arnold Schwarzenegger's call to reduce spending. At the same time, the legislature gerrymandered its state-level voting districts. These twin actions set up a "vicious cycle" of unproductivity in Sacramento, with Schwarzenegger unable to lead on taxing and spending issues for the rest of his tenure.

The state remains trapped because its laws allowed public employees' salaries to rise so high they virtually bankrupted local municipalities. The bursting of the housing bubble made a terrible situation even worse. California, and some of its cities, such as San Jose and Vallejo, are symbols of the kinds of actions that plunged the US into this mess: "people taking what they can, just because they can, without regard to the larger social consequences."

"A banking system is an act of faith: It survives only for as long as people believe it will."

Epilogue

By 2012, Iceland had "walked away" from its debts and "returned to fishing." Ireland elected a new government, but not one that took the repayment burden off its taxpayers' backs. Greece defeated its government, as well, but left its commitment to the euro up in the air. The world is asking Germany to get it off the hook. And "no one on Wall Street has been shot or even jailed."

About the Author

Michael Lewis, the best-selling author of *Moneyball* and *Liar's Poker*, has also written for *Vanity Fair*, *The New York Times* and *Slate*.