

# WHEN IRISH EYES ARE CRYING

First Iceland. Then Greece. Now Ireland, which headed for bankruptcy with its own mysterious logic. In 2000, suddenly among the richest people in Europe, the Irish decided to buy their country—*from one another*. After which their banks and government really screwed them. So where's the rage?

BY MICHAEL LEWIS



#### CRASH COURSE

University College Dublin professor Morgan Kelly, in Hogans pub, in Dublin. He predicted the Irish Crash in 2006.

When I flew to Dublin in early November, the Irish government was busy helping the Irish people come to terms with their loss. It had been two years since a handful of Irish politicians and bankers decided to guarantee all the debts of the country's biggest banks, but the people were only now getting their minds around what that meant for them. The numbers were breathtaking. A single bank, Anglo Irish, which, two years before, the Irish government had claimed was

merely suffering from a "liquidity problem," faced losses of up to 34 billion euros. To get some sense of how "34 billion euros" sounds to Irish ears, an American thinking in dollars needs to multiply it by roughly one hundred: \$3.4 trillion. And that was for *a single bank*. As the sum total of loans made by Anglo Irish, most of it to Irish property developers, was only 72 billion euros, the bank had lost nearly half of every dollar it invested.

The two other big Irish banks, Bank of Ireland and, especially, Allied Irish Banks (A.I.B.), remained Ireland's dirty little secrets. Both older than Ireland itself (the

Bank of Ireland was founded back in 1783; A.I.B. is made up of three banks founded in the 19th century), both were now also obviously bust. The Irish government owned big chunks of the two ancient banks but revealed less about them. As they had lent vast sums not only to Irish property developers but also to Irish homebuyers, their losses were also obviously vast—and similar in spirit to the losses at the upstart Anglo Irish.

Even in an era when capitalists went out of their way to destroy capitalism, the Irish bankers set some kind of record for destruction. Theo Phanos, a London hedge-fund manager with interests in Ire-

PRODUCED ON LOCATION BY YOKO PRODUCTIONS

land, says that “Anglo Irish was probably the world’s worst bank. Even worse than the Icelandic banks.”

Ireland’s financial disaster shared some things with Iceland’s. It was created by the sort of men who ignore their wives’ suggestions that maybe they should stop and ask for directions, for instance. But while Icelandic males used foreign money to conquer foreign places—trophy companies in Britain, chunks of Scandinavia—the Irish male used foreign money to conquer Ireland. Left alone in a dark room with a pile of money, the Irish decided what they really wanted to do with it was to buy Ireland. *From one another.* An Irish economist named Morgan Kelly, whose estimates of Irish bank losses have been the most prescient, made a back-of-the-envelope calculation that puts the losses of all Irish banks at roughly 106 billion euros. (Think \$10 trillion.) At the rate money currently flows into the Irish treasury, Irish bank losses alone would absorb every penny of Irish taxes for at least the next three years.

In recognition of the spectacular losses, the entire Irish economy has almost dutifully collapsed. When you fly into Dublin you are traveling, for the first time in 15 years, against the traffic. The Irish are once again leaving Ireland, along with hordes of mi-

rate persuade the citizens to quit cheating on their taxes. (The new Greek prime minister is not merely upstanding, but barely Greek.) Ireland was the first European country to watch its entire banking system fail, and yet its business-friendly conservative party, Fianna Fáil (pronounced “Feena Foil”), would remain in office into 2011. There’s been no Tea Party movement, no Glenn Beck, no serious protests of any kind. The most obvious change in the country’s politics has been the role played by foreigners. The Irish government and Irish banks are crawling with American investment bankers and Australian management consultants and faceless Euro-officials, referred to inside the Department of Finance simply as “the Germans.” Walk the streets at night and, through restaurant windows, you see important-looking men in suits, dining alone, studying important-looking papers. In some new and strange way Dublin is now an occupied city: Hanoi, circa 1950. “The problem with Ireland is that you’re not allowed to work with Irish people anymore,” I was told by an Irish property developer, who was finding it difficult to escape the hundreds of millions of euros in debt he owed.

Ireland’s regress is especially unsettling because of the questions it raises about Ire-

land. How did that happen? A bright young Irishman who got himself hired by Bear Stearns in the late 1990s and went off to New York or London for five years returned feeling *poor*. For the better part of a decade there has been quicker money to be made in Irish real estate than in investment banking. How did *that* happen?

For the first time in history, people and money longed to get into Ireland rather than out of it. The most dramatic case in point are the Poles. The Polish government keeps no comprehensive statistics on the movement of its workforce, but its foreign ministry guesstimates that, since the country’s admission to the European Union, more than a million Poles have left Poland to work elsewhere. At the peak, in 2006, as many as a quarter-million of them were in Ireland. For the United States to achieve a proportionally distortive demographic effect, it would need to hand green cards to 17 million Mexicans.

How did any of this happen? There are many theories: the elimination of trade barriers, the decision to grant free public higher education, the persistent lowering of the corporate tax rate, beginning in the 1980s, which turned Ireland into a tax haven for foreign

## “[IRISH PROSPERITY] APPEARED LIKE A MIRACULOUS BEAST IN A FOREST CLEARING.”

grant workers. In late 2006, the unemployment rate stood at a bit more than 4 percent; now it’s 14 percent and climbing toward rates not experienced since the mid-1980s. Just a few years ago, Ireland was able to borrow money more cheaply than Germany; now, if it can borrow at all, it will be charged interest rates nearly 6 percent higher than Germany, another echo of a distant past. The Irish budget deficit—which three years ago was a surplus—is now 32 percent of its G.D.P., the highest by far in the history of the Eurozone. One credit-analysis firm has judged Ireland the third-most-likely country to default. Not quite as risky for the global investor as Venezuela, but riskier than Iraq. Distinctly Third World, in any case.

Yet when I arrived, in early November 2010, Irish politics had a frozen-in-time quality to it. In Iceland, the business-friendly conservative party had been quickly tossed out of power, and the women booted the alpha males out of the banks and government. (Iceland’s new prime minister is a lesbian.) In Greece the business-friendly conservative party was also given the heave-ho, and the new government is attempting to create a sense of collective purpose, or at any

land’s former progress: even now no one is quite sure why the Irish suddenly did so well for themselves in the first place. Between 1845 and 1852, during the Great Potato Famine, the country experienced the greatest loss of population in world history—in a nation of eight million, a million and a half people left. Another million starved to death or died from the effects of hunger. Inside of a decade the nation went from being among the most densely populated in Europe to the least. The founding of the Irish state, in 1922, might have offered some economic hope—they could now have their own central bank, their own economic policies—but right up until the end of the 1980s the Irish failed to do what economists expected them to: catch up with their neighbors’ standard of living. As recently as the 1980s one million Irish people—a third of the population—lived below the poverty line.

What has occurred in Ireland since then is without precedent in economic history. By the start of the new millennium, the Irish poverty rate was under 6 percent and by 2006 Ireland was one of the richest countries in the world.

corporations. Maybe the most intriguing was offered by a pair of demographers at Harvard, David E. Bloom and David Canning, in a 2003 paper called “Contraception and the Celtic Tiger.” Bloom and Canning argued that a major cause of the Irish boom was a dramatic increase in the ratio of working-age to non-working-age Irish brought about by a crash in the Irish birthrate. This had been driven mainly by Ireland’s decision, in 1979, to legalize birth control. That is, a nation’s fidelity to the Vatican’s edicts was inversely proportional to its ability to climb out of poverty: out of the slow death of the Catholic Church arose an economic miracle.

The Harvard demographers admitted their theory explained only part of what had happened. At the bottom of the success of the Irish there remains, even now, some mystery. “It appeared like a miraculous beast materializing in a forest clearing,” writes the pre-eminent Irish historian R. F. Foster, “and economists are still not entirely sure why.” Not knowing why they were so suddenly so successful, the Irish can perhaps be forgiven for not knowing exactly how successful they were meant to be. They had gone from being abnormally

poor to being abnormally rich, without pausing to experience normality. When, in the early 2000s, the financial markets began to offer virtually unlimited credit to all comers—when nations were let into the dark room with the pile of money and asked what they would like to do with it—the Irish were already in a peculiarly vulnerable state of mind. They'd spent the better part of a decade under something very like a magic spell.

A few months after the spell was broken, the short-term parking-lot attendants at Dublin Airport noticed that their daily take had fallen. The lot appeared full; they couldn't understand it. Then they noticed the cars never changed. They phoned the Dublin police, who in turn traced the cars to Polish construction workers, who had bought them with money borrowed from Irish banks. The migrant workers had ditched the cars and gone home. Rumor has it that a few months later the Bank of Ireland sent three collectors to Poland to see what they could get back, but they had no luck. The Poles were untraceable: but for their cars in the short-term parking lot, they might never have existed.

#### True Love's First Kiss

Morgan Kelly is a professor of economics at University College Dublin, but he did not, until recently, view it as his business to think much about the economy under his nose. He had written a handful of highly regarded academic



#### NOBODY HOME

A "ghost estate" in County Leitrim. There are hundreds of them in Ireland.

The statement struck him as absurd: real-estate bubbles never end with soft landings. A bubble is inflated by nothing firmer than expectations. The moment people cease to believe that house prices will rise forever, they will notice what a terrible long-term investment real estate has become and flee the market, and the market will *crash*. It was in the nature of real-estate booms to end with crashes—just as it was perhaps in Morgan Kelly's nature to assume that, if his former students were cast on Irish TV as financial experts, something was amiss. "I just started Googling things," he says.

Googling things, Kelly learned that more than a fifth of the Irish workforce was employed building houses. The Irish construction industry had swollen to become nearly a quarter of the country's G.D.P.—compared with less than 10 per-

Where would this growth come from? Since 2000, Irish exports had stalled, and the economy had been consumed with building houses and offices and hotels. "Competitiveness didn't matter," says Kelly. "From now on we were going to get rich building houses for each other."

The endless flow of cheap foreign money had teased a new trait out of a nation. "We are sort of a hard, pessimistic people," says Kelly. "We don't look on the bright side."

Yet, since the year 2000, a lot of people had behaved as if each day would be sunnier than the last. The Irish had discovered optimism.

Their 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. After all, once the value of Irish real estate came untethered from rents there was no value for it that couldn't be justified. The 35 million euros Irish entrepreneur Denis O'Brien paid for an impressive manor house on Dublin's Shrewsbury Road sounded like a lot until a trust controlled by the real-estate developer Sean Dunne's wife reportedly paid 58 million euros for a 4,000-square-foot fixer-upper just down the street. But the minute you compared the rise in prices to real-estate booms elsewhere and at other times, you re-anchored the conversation; you biffed the narrative. The comparisons that

## NORMALIZING A FREAK SHOW IS NOW PART OF THE JOB OF BEING IRISH FINANCE MINISTER.

papers on topics (such as "The Economic Impact of the Little Ice Age") considered abstruse even by academic economists. "I only stumbled on this catastrophe by accident," he says. "I had never been interested in the Irish economy. The Irish economy is tiny and boring." Kelly saw house prices rising madly and heard young men in Irish finance to whom he had recently taught economics try to explain why the boom didn't trouble them. And they troubled him. "Around the middle of 2006 all these former students of ours working for the banks started to appear on TV!" he says. "They were now all bank economists, and they were nice guys and all that. And they were all saying the same thing: 'We're going to have a soft landing.'"

cent in a normal economy—and Ireland was building half as many new houses a year as the United Kingdom, which had almost 15 times as many people to house. He learned that since 1994 the average price for a Dublin home had risen more than 500 percent. In parts of the city, rents had fallen to less than 1 percent of the purchase price—that is, you could rent a million-dollar home for less than \$833 a month. The investment returns on Irish land were ridiculously low: it made no sense for capital to flow into Ireland to develop more of it. Irish home prices implied an economic growth rate that would leave Ireland, in 25 years, three times as rich as the United States. ("A price/earning ratio above Google's," as Kelly put it.)

sprung to Morgan Kelly's mind were with the housing bubbles in the Netherlands in the 1970s and Finland in the 1980s, but it almost didn't matter which examples he picked: the mere idea that Ireland was not *sui generis* was the panic-making thought. "There is an iron law of house prices," he wrote. "The more house prices rise relative to income and rents, the more they subsequently fall."

The problem for Kelly, once he had these thoughts, was what to do with them. "This isn't my day job," he says. "I was working on medieval-population theory."

By the time I got to him, Kelly had angered and alienated the entire Irish business and political establishments, but he himself is neither angry nor alienated, nor

even especially public. He's not the pundit type. He works in an office built when Irish higher education was conducted on linoleum floors, beneath fluorescent lights, surrounded by metal bookshelves, and generally felt more like a manufacturing enterprise than a prep school for real estate and finance—and he likes it. He's puckish, unrehearsed, and apparently—though in Ireland one wants to be careful about using this word—sane. Though not exactly self-effacing, he is clearly more comfortable talking and thinking about subjects other than himself. He spent years in graduate school, collecting a doctorate from Yale, and yet somehow retained an almost child-like curiosity. “I was in this position—sort of being a passenger on this ship,” he says. “And you see a big iceberg. And so you go and ask the captain: Is that an iceberg?”

His warning to his ship's captain took the form of his first-ever newspaper article. Its bottom line: “It is not implausible that [Irish real-estate] prices could fall—relative to income—by 40 to 50 per cent.” (They did.) He sent his piece to the small-circulation *Irish Times*. “It was

to be catastrophic. The banks' losses would lead them to slash their lending to actually useful businesses. Irish citizens in hock to their banks would cease to spend. And, perhaps worst of all, new construction, on which the entire economy was now premised, would cease.

Kelly wrote his second newspaper article, more or less predicting the collapse of the Irish banks. He pointed out that in the last decade they and the economy had fundamentally changed. In 1997 the Irish banks were funded entirely by Irish deposits. By 2005 they were getting most of their money from abroad. The small German savers who ultimately supplied the Irish banks with deposits to re-lend in Ireland could take their money back with the click of a computer mouse. Since 2000, lending to construction and real estate had risen from 8 percent of Irish bank lending (the European norm) to 28 percent. One hundred billion euros—or basically the sum total of all Irish public bank deposits—had been handed over to Irish property developers and speculators. By 2007, Irish banks were lending 40 percent more to property developers

to write a learned attack on Kelly's piece. (The department head refused.) A senior executive at Anglo Irish Bank, Matt Moran, called to holler at Kelly. “He went on about how ‘the real-estate developers who are borrowing from us are so incredibly rich they are only borrowing from us as a favor.’ I wanted to argue, but we ended up having lunch. This is Ireland, after all.” Kelly also received a flurry of worried-sounding messages from financial people in London, but of these he was dismissive: “I get the impression there's this pool of analysts in the financial markets who spend all day sending scary e-mails to each other.” He never found out how much influence his little newspaper piece exerted on the minds of people who mattered.

It wasn't until almost exactly one year later, on September 29, 2008, that Morgan Kelly became the startled object of popular interest. The stocks of the three main Irish banks, Anglo Irish, A.I.B., and Bank of Ireland, had fallen by between a fifth and a half in a single trading session, and a run on Irish bank deposits had started. The Irish government was about to guarantee all the obligations of the six

## WHAT THEY NEGLECTED TO MENTION WAS THAT ALL OF IRELAND HAD BECOME SUBPRIME.

a whim,” he says. “I'm not even sure that I believed what I was saying at the time. My position has always been ‘You can't predict the future.’” As it happened, Kelly had predicted the future with uncanny accuracy, but to believe what he was saying you had to accept that Ireland was not some weird exception in human financial history. “It had no impact,” Kelly says of his piece. “The response was general amusement. It was *What will these crazy eggheads come up with next?* sort of stuff.”

What the crazy egghead came up with next was the obvious link between Irish real-estate prices and Irish banks. After all, the vast majority of the construction was being funded by Irish banks. If the real-estate market collapsed, they would be on the hook for the losses. “I eventually figured out what was going on,” says Kelly. “The average value and number of new mortgages peaked in summer 2006. But lending standards were clearly falling after this.” The banks continued to make worse loans, but people borrowing the money to buy houses were growing wary. “What was happening,” says Kelly, “is that a lot of people were getting cold feet.” The consequences for Irish banks—and the economy—of the inevitable shift in market sentiment would

than they had to the *entire Irish population* seven years earlier. “You probably think that the fact that Irish banks have given speculators €100 billion to gamble with, safe in the knowledge that taxpayers will cover most losses, is a cause of concern to the Irish Central Bank,” Kelly wrote, “but you would be quite wrong.”

This time Kelly sent his piece to a newspaper with a far bigger circulation, the *Irish Independent*. The *Independent's* editor wrote back to say he found the article offensive and wouldn't publish it. Kelly next turned to *The Sunday Business Post*, but the editor there just sat on the piece. The journalists were following the bankers' lead and conflating a positive outlook on real-estate prices with a love of country and a commitment to Team Ireland. (“They'd all use this same phrase, ‘You're either for us or against us,’” says a prominent bank analyst in Dublin.) Kelly finally went back to *The Irish Times*, which ran his article in September 2007.

A brief and, to Kelly's way of thinking, pointless controversy ensued. The public-relations guy at University College Dublin called the head of the department of economics and asked him to find someone

biggest Irish banks. The most plausible explanation for all of this was Morgan Kelly's narrative: the Irish economy had become a giant Ponzi scheme and the country was effectively bankrupt. But it was so starkly at odds with the story peddled by Irish government officials and senior Irish bankers—that the banks merely had a “liquidity” problem and that Anglo Irish was “fundamentally sound”—that the two could not be reconciled. The government had a report thrown together by Merrill Lynch, which declared that “all of the Irish banks are profitable and well capitalised.” The difference between this official line and Kelly's was too vast to be split. You believed either one or the other, and until September 2008, who was going to believe this guy holed up in his office wasting his life writing about the impact of the Little Ice Age on the English population? “I went on TV,” says Kelly. “I'll never do it again.”

Kelly's colleagues in the University College economics department watched his transformation from serious academic to amusing crackpot to disturbingly prescient guru with interest. One was Colm McCarthy, who, in the Irish recession of the late 1980s, had played a

Finance Minister  
Brian Lenihan, in the  
Department of Finance  
building in Dublin.  
He made Irish-bank  
bondholders  
whole.

high-profile role in slashing government spending, and so had experienced the intersection of finance and public opinion. In McCarthy's view, the dominant narrative inside the head of the average Irish citizen—and his receptiveness to the story Kelly was telling—changed at roughly 10 o'clock in the evening on October 2, 2008. On that night, Ireland's financial regulator, a lifelong Central Bank bureaucrat in his 60s named Patrick Neary, came live on national television to be interviewed. The interviewer sounded as if he had just finished reading the collected works of Morgan Kelly. Neary, for his part, looked as if he had been dragged from a hole into which he badly wanted to return. He wore an insecure little mustache, stammered rote answers to questions he had not been asked, and ignored the ones he had been asked.

A banking system is an act of faith: it survives only for as long as people believe it will. Two weeks earlier the collapse of Lehman Brothers had cast doubt on banks everywhere. Ireland's banks had not been managed to withstand doubt; they had been managed to exploit blind faith. Now the Irish people finally caught a glimpse of the guy meant to be safeguarding them: the crazy uncle had been sprung from the family cellar. Here he was, on their televisions, insisting that the Irish banks were "resilient" and "more than adequately capitalized" . . . when everyone in Ireland could see, in the vacant skyscrapers and empty housing developments around them, evidence of bank loans that were not merely bad but insane. "What happened was that everyone in Ireland had the idea that somewhere in Ireland there was a little wise old man who was in charge of the money, and this was the first time they'd ever seen this little man," says McCarthy. "And then they saw him and said, *Who the fuck was that??? Is that the fucking guy who is in charge of the money???* That's when everyone panicked."



## “THIS ISN'T ICELAND. WE'RE NOT A HEDGE FUND THAT'S POPULATED BY 300,000 FARMERS.”

### The Drinks Cabinet

On the morning in early November when the Irish government planned to unveil a brutal new budget, I take my seat in the visitors' gallery of the Irish Parliament. Beside me sits an aide to Joan Burton, who, as the Labour Party's financial spokesperson, was at the time a fair bet to become the next minister of finance, the unnatural heir to an unholy mess. Down on the floor the seats are mostly empty, but a handful of politicians, Burton included, discuss what they

have been discussing without intermission for the past two years: the nation's financial crisis.

The first thing you notice when you watch the Irish Parliament at work is that the politicians say everything twice, once in English and once in Gaelic. As there is no one in Ireland who does not speak English and a vast majority who do not speak Gaelic, this comes across as a forced gesture that wastes a great deal of time. I ask several Irish politicians if they speak Gaelic, and all offer the same uneasy look and

hedgy reply: "Enough to get by." The politicians in Ireland speak Gaelic the way the Real Housewives of Orange County speak French. To ask "Why bother to speak it at all?" is of course to miss the point. Everywhere you turn you see both emulation of the English and a desire, sometimes desperate, for distinction. The Irish insistence on their Irishness—their conceit that they're more devoted to their homeland than the typical citizen of the world is—has an element of bluster about it, from

top to bottom. At the top are the many very rich Irish people who emit noisy patriotic sounds but arrange officially to live elsewhere so they don't have to pay tax in Ireland; at the bottom, the waves of emigration that define Irish history. The Irish people and their country are like lovers whose passion is heightened by their suspicion that they will probably wind up leaving each other. Their loud patriotism is a cargo ship for their doubt.

On this day, in addition to awaiting word on the budget, the Dáil (pronounced "Doyle"), as the Irish call their House of Commons, has before it a vote on whether

it into the press gallery, 10 feet below, and from there rappelled down the wall to the floor. They allowed the vote, but put up the glass barrier. They disapproved of the loophole, but rewarded the guy with the wit to exploit it. This, she claims, is very Irish.

The first to take his seat is Bertie Ahern, the prime minister from June 1997 until May 2008 and Political Perp No. 1. Ahern is known both for a native shrewdness and for saying lots of spectacularly dumb-sounding things that are fun to quote. Tony Blair had credited him with a kind of genius in how he brokered the Northern Ireland peace negotiations;

dog slouch and a face mottled by broken capillaries. To fill the empty hours, he's taken a job writing a sports column for the Rupert Murdoch tabloid *News of the World*, which might just be the least respectable job in global journalism. Ahern's star, such as it was, has fallen.

When the Irish land boom flipped from miracle to catastrophe, a lot of important people's status, along with perhaps their sense of themselves, flipped with it. An Irish stockbroker told me that many former bankers, some of whom he counts as clients, "actually physi-

## "DO YOU KNOW THAT IRISH PEOPLE ARE NOW EXPERTS ON BONDS?" SAYS JOAN BURTON.

to hold elections to fill its four empty seats. The ruling party, Fianna Fáil, holds a slim majority of two seats and, because they are universally believed to have created a financial catastrophe, an approval rating of 15 percent. If the elections were held today, they'd be tossed from power—in itself a radical idea, as they have more or less ruled Ireland since its founding as an independent state. Yet they have successfully resisted the call to fill the empty seats.

A bell rings for a vote, and Irish politicians stream in. A few minutes before the vote, the doors to their chamber will be closed and guarded. A politician who is late is a politician who cannot vote. A glass barrier separates the visitors' gallery and the floor:

I ask my tour guide about it. "It's not to stop people from throwing things at their government," she says, then goes on to explain. Some years ago an Irish politician came late, after the doors had been locked. He ran up to the visitors' gallery, jumped down from

on the other hand, seeking to explain the financial crisis, he actually said, "Lehman's was a world investment bank. They had testicles everywhere." Ahern spent his last days in office denying he'd accepted bribes from property developers, at least in part because so much of what he did in office seemed justified only if he were being paid by property developers to do it. But Bertie Ahern too obviously believed in the miracle of Irish real estate. After Morgan Kelly published his article predicting the collapse of the Irish banks, for instance, Ahern famously responded to a question about it on national radio by saying, "Sitting on the sidelines, cribbing and moaning is a lost opportunity. I don't know how people who engage in that don't commit suicide."

Now Ahern is just another Irish backbencher, with a hang-

cally look different." He'd just seen the former C.E.O. of A.I.B., Eugene Sheehy, in a restaurant, being heckled by other diners. Sheehy once had been a smooth and self-possessed character, whose authority was beyond question. "If you saw the guy now," says my stockbroker friend, "you'd buy him a cup o' tea."

The Irish real-estate bubble was different from the American version in many ways: it wasn't disguised, for a start; it didn't require a lot of complicated financial engineering beyond the understanding of mere mortals; it also wasn't as cynical. There aren't a lot of Irish financiers or real-estate people who have emerged with a future. In America the banks went down, but the big shots in them still got rich; in Ireland the big shots went down with the banks. Sean Fitzpatrick, a working-class kid turned banker, who built Anglo Irish Bank more or less from scratch, is widely viewed as the chief architect of Ireland's misfortune: today he is not merely bankrupt but unable to show his face in public. Mention his name and people with no interest in banking will tell you with disgust how he disguised millions of euros in loans made to himself by his own bank. What they don't mention is what he did with



**CELTIC TIGERS**  
Clockwise from far left: financial regulator Patrick Neary on Irish TV; Labour's Joan Burton; former prime minister Bertie Ahern; former Anglo Irish chairman Sean Fitzpatrick; Prime Minister Brian Cowen.

PHOTOGRAPHS BY JUIEN BEHAL/PRESS ASSOCIATION (BURTON); GARRY O'NEILL (FITZPATRICK); FROM REK USA (AHERN); BY JEAN-CHRISTOPHE VERHAEGEN/AP/GETTY IMAGES (COWEN)



the money: invested it in Anglo Irish bonds! When the bank failed Fitzpatrick was listed among its creditors, having (in April 2008!) purchased five million euros of Anglo Irish subordinated floating-rate notes.

The top executives of the three big banks all operated in a similar spirit: they bought shares in their own companies right up to the moment of collapse, and continued to pay dividends, as if they had capital to burn. Virtually all of the big Irish property developers who behaved recklessly signed personal guarantees for their loans. It's widely assumed that they must be hiding big piles of money somewhere,

Finance Minister Brian Lenihan. Along with the leader of the opposition, and the second in command of their own party, both are offspring of politicians who died in office: Irish politics is a family affair. Cowen happens also to have been the minister of finance from 2004 until mid-2008, when most of the bad stuff happened. He is not an obvious Leader of Men. His movements are sullen and lumbering, his face numbed by corpulence, his natural resting expression a look of confusion. One morning a few weeks before, he went on national radio sounding, to well-trained Irish ears, drunk. To my less trained ones he sounded

## IRELAND'S BANKS HAD BEEN MANAGED TO EXPLOIT BLIND FAITH.

but the evidence thus far suggests that they are not. The Irish Property Council has counted at least 29 suicides by property developers and construction workers since the crash—in a country where suicide often goes unreported and undercounted. “I said to all the guys, ‘Always take money off the table.’ Not many of them took money off the table,” says Dermot Desmond, an Irish billionaire, who made his fortune from software in the early 1990s, and so counts here as old money.

The Irish nouveau riche may have created a Ponzi scheme, but it was a Ponzi scheme in which they themselves believed. So too for that matter did some large number of ordinary Irish citizens, who bought houses for fantastic sums. Ireland's 87 percent rate of home-ownership is among the highest in the world. There's no such thing as a non-recourse home mortgage in Ireland. The guy who pays too much for his house is not allowed to simply hand the keys to the bank and walk away. He's on the hook, personally, for whatever he borrowed. Across Ireland, people are unable to extract themselves from their houses or their bank loans. Irish people will tell you that, because of their sad history of dispossession, owning a home is not just a way to avoid paying rent but a mark of freedom. In their rush to freedom, the Irish built their own prisons. And their leaders helped them to do it.

**J**ust before the closing bell, the two men who sold the Irish people on the notion that they, the people, were responsible not merely for their own disastrous financial decisions but also for the ones made by their banks arrive in the chamber: Prime Minister Brian Cowen and

merely groggy, but the public is in no mood to cut him a break. (Four different Irish people told me, on great authority, that Cowen had faxed Ireland's 440-billion-euro bank guarantee into the European Central Bank from a pub.) And the truth is, if you were to design a human being to maximize the likelihood that people would assume he drank too much, you'd have a hard time doing better than the Irish prime minister. Lenihan, who follows on Cowen's bovine heels, comes across, by comparison, as a decathlete in peak condition.

On this day, incredibly yet predictably, the Parliament decides not to hold a vote to fill three of the four empty seats. Then they adjourn, and I spend an hour with Joan Burton. Of the major parties in Ireland, Labour offers the closest thing to a dissenting opinion and a critique of Irish capitalism. As one of only 18 members of the Dáil who voted against guaranteeing the banks' debts, Burton retains rare credibility. And in an hour of chatting about this and that, she strikes me as straight, bright, and basically good news. But her role in the Irish drama is as clear as Morgan Kelly's: she's the shrill mother no one listened to. She speaks in exclamation points with a whiny voice that gets on the nerves of every Irishman—to the point where her voice is parodied on national radio. When I ask her what she would do differently from what the Irish government is doing, even she is stumped. Like every other Irish politician, she is now at the mercy of forces beyond her control. The Irish bank debt is now Irish government debt, and any suggestion of default will only raise the cost of borrowing the foreign money they now can't live without. “Do you know that Irish people

are now experts on bonds?” says Burton. “Yes, they now say 100 basis points rather than 1 percent! They have developed a new vocabulary!”

As the scope of the Irish losses has grown clearer, private investors have been less and less willing to leave even overnight deposits in Irish banks and are completely uninterested in buying longer-term bonds. The European Central Bank has quietly filled the void: one of the most closely watched numbers in Europe has been the amount the E.C.B. has loaned to the Irish banks. In late 2007, when the markets were still suspending disbelief, the banks borrowed 6.5 billion euros. By December of 2008 the number had jumped to 45 billion. As Burton spoke to me, the number was still rising from a new high of 86 billion. That is, the Irish banks have borrowed 86 billion euros from the European Central Bank to repay private creditors. In September 2010 the last big chunk of money the Irish banks owed the bondholders, 26 billion euros, came due. Once the bondholders were paid off in full, a window of opportunity for the Irish government closed. A default of the banks now would be a default not to private investors but a bill presented directly to European governments. This, by the way, is why there are so many important-looking foreigners in Dublin, dining alone at night. They're here to make sure someone gets his money back.

One measure of how completely the Irish can't imagine offending their foreign financial rulers is how quickly Burton declines to contemplate such a default. She bears no responsibility for the banks' private debts, and yet, when we creep up on the possibility of simply walking away from them, she veers off. Actually, she ups and leaves. “Oh, I have to go,” she says. “I have to meet the finance minister with the bad news.” Brian Lenihan has called a private meeting with the opposition, so that its leaders will be the first to hear of the Draconian new Irish budget. This meeting is held not inside the Parliament, where the media can be kept at arm's length, but in a nearby building, where the media are allowed to congregate. “We tried to have it in here, but he moved it outside,” says Burton. “He's taken to bringing us in to tell us the bad news first so that when we walk out we're the ones announcing it to the media.” She smiles. “He's tricky that way.”

#### Ireland's Choice

**B**rian Lenihan is the last remaining Irish politician anywhere near power whose mere appearance does not cause people on the streets of Dublin to explode with either scorn or laughter. He came to the job just months before the crisis and so escapes blame for its

origins. He's a barrister, not a financial or real-estate person, with a proven ability to earn a good living without being bribed by property developers. He comes from a family of political people who are thought to have served honorably, or at any rate not used politics to enrich themselves. And in December 2009 he was diagnosed with pancreatic cancer. Anyone who has been anywhere near an Irish Catholic family knows the member who has had the most recent run of bad luck enjoys exalted status—the right to do pretty much whatever he wants, while everyone else squirms in silence. Since news of Lenihan's illness broke—just days after he'd learned of it himself, rushing him into telling his children—he has minimized his suffering. Underlying the public-opinion polls that show the Irish feel a lot better about the minister of finance than they do about other politicians in his party is a common, unspoken understanding of his bravery.

Brian Lenihan is also, as Joan Burton points out, tricky. It's racing up on eight in the evening when I meet him in a Department of Finance conference room. He has spent most of his day defending the harshest spending cuts and tax hikes in Irish history to Irish politicians, without offering any details about who, exactly, will pay for the banks' losses. (He's waiting to do that until after the single by-election the Dáil authorized is held.) He smiles. “Why is everyone so interested in Ireland?” he asks almost innocently. “There's really far too much interest in us right now.”

“Because you're interesting?” I say.

“Oh no,” he says seriously. “We're not, really.”

He proceeds to make the collapse of the Irish economy as uninteresting as possible. This awkward social responsibility—normalizing a freak show—is now a meaningful part of the job of being Ireland's finance minister. At just the moment the crazy uncle leapt from the cellar, the drunken aunt lurched through the front door and, in front of the entire family and many important guests, they carved each other to bits with hunting knives. Daddy must now reassure eyewitnesses that they didn't see what they think they saw.

**B**ut the physical evidence that something deeply weird just happened in Ireland is still too conspicuous. A mile from the conference table where we take our seats is a moonscape of vast, two-year-old craters from which office parks were once meant to rise. There are fully finished skyscrapers that sit empty, water pooling on their lobby floors. There's a skeleton of a tower, cranes resting on either side like parentheses, which was meant to house Anglo Irish Bank. There's

a city dump for which a developer paid 412 million euros in 2006—and which is now, when you include the cleanup costs, valued at zero. “Ireland is very unusual,” says William Newsom, who has more than 30 years of experience valuing commercial real estate for Savills in London. “There are whole swaths of either undeveloped land with planning permission or even partially developed sites which, I believe, for practical purposes have zero value.” The peak of the Irish madness is frozen in time, for all

or the 90s. This is all in a much narrower band.” And then he goes off on a soliloquy, the main point of which is: *Ireland’s problems are solvable, and I am in control of the situation.*

Back in September 2008, however, there was evidence that he wasn’t. On September 17 the financial markets were in turmoil. Lehman Brothers had failed two days earlier, shares of Irish banks were plummeting, and big corpora-

markets. Now he wanted to drive out to McWilliams’s house and ask his advice on what to do about the Irish banks.

The peculiar scene is described in McWilliams’s charmingly indiscreet book, *Follow the Money*. Lenihan arrives at the McWilliams residence, a 45-minute drive from Dublin, marches through to the family kitchen, and pulls a hunk of raw garlic out of his jacket pocket. “He kicked off by saying if his officials knew he was here in my house, there’d be war,” writes McWilliams.

## “I [TOLD] ALL THE GUYS, ‘ALWAYS TAKE MONEY OFF THE TABLE.’ NOT MANY OF THEM [DID].”

to see. There’s even an empty Starbucks, in the heart of what was meant to be a global financial center to rival London’s, where a carton of low-fat milk curdles beside a silver barista pitcher. The finance minister might as well be standing in Pompeii and saying that actually the volcano wasn’t really worth mentioning. *Just a little lava!*

“This isn’t Iceland” is what Lenihan actually says. “We’re not a hedge fund that’s populated by 300,000 farmers and fishermen. Ireland is not going back to the 80s

tions were withdrawing their deposits from them. Late that evening Lenihan phoned David McWilliams, a former senior European economist with UBS in Zurich and London, who had moved back home to Dublin and turned himself into a writer and media personality. McWilliams had been loudly skeptical about the Irish real-estate boom. Two weeks earlier he had appeared on a radio show with Lenihan, and Lenihan appeared to him entirely untroubled by the turmoil in the financial

The finance minister stayed until two in the morning, drinking tea and anxiously picking McWilliams’s brain. McWilliams came away with the feeling that the minister didn’t entirely trust the advice he was getting from the people around him—and that he was not merely worried but confused. McWilliams told me that he sensed that the mental state of the Department of Finance was “complete chaos.”

A week later the department hired investment bankers from Merrill Lynch to advise



### THE GADFLY

Economist, author, and media personality David McWilliams, in front of the Bank of Ireland and Trinity College, in Dublin.

it. Some might say that if you were asking Merrill Lynch for financial advice in 2008 you were already beyond hope, but that is not entirely fair. The bank analyst who had been most prescient and interesting about the Irish banks worked for Merrill Lynch. His name was Philip Ingram. In his late 20s, and a bit quirky—at the University of Cambridge he had studied zoology—Ingram had done something original and useful: he'd shined a new light on the way Irish banks lent against commercial real estate.

The commercial-real-estate loan market is generally less transparent than the market for home loans. Deals between bankers and property developers are one-offs, on terms unknown to all but a few insiders. The parties to any loan always claim it is prudent: a bank analyst has little choice but to take them at their word. But Ingram was skeptical of the Irish banks. He had read Morgan Kelly's newspaper articles and even paid Kelly a visit in his university office. To Ingram's eyes, there undoubtedly appeared to be a vast difference between what the Irish banks were saying and what was really happening. To get at it he ignored what they were saying and went looking for knowledgeable insid-

er-in-house lawyers, who toned down the report's pointed language and purged it of its damning quotes from market insiders, including its many references to Irish banks. And from that moment everything Ingram wrote about Irish banks was edited, and bowdlerized by Merrill Lynch's lawyers. At the end of 2008, Merrill fired him. One of Ingram's colleagues, a fellow named Ed Allchin, was also made to apologize to Merrill's investment bankers individually for the trouble he'd caused them by suggesting there was still money to be made on shorting Irish banks.

It would have been difficult for Merrill Lynch's investment bankers not to know, at some level, that in a reckless market the Irish banks had acted with a recklessness all their own. But in the seven-page memo to Brian Lenihan—for which the Irish taxpayer forked over to Merrill Lynch seven million euros—they kept whatever reservations they may have had to themselves. "All of the Irish banks are profitable and well capitalised," wrote the Merrill Lynch advisers, who then went on to suggest that the banks' problem wasn't at all the bad loans they had made but the panic in the market.

bank analyst tells me. "We don't have any subprime." What they meant was that they had avoided lending to American subprime borrowers; what they neglected to mention was that, in the general frenzy, all of Ireland had become subprime. Otherwise sound Irish borrowers had been rendered unsound by the size of the loans they had taken out to buy inflated Irish property. That had been the strangest consequence of the Irish bubble: to throw a nation which had finally clawed its way out of centuries of indentured servitude back into it.

The report from Merrill Lynch, which touted the banks as fundamentally sound, buttressed whatever story they told the finance minister. Ireland's financial regulator, Patrick Neary, had echoed Merrill's judgment. Morgan Kelly was still viewed as a zany egghead; at any rate, no one who took him seriously was present in the room. Anglo Irish's stock had fallen 46 percent that day; A.I.B.'s had fallen 17 percent; there was a fair chance that when the stock exchange reopened one or both of them would go out of business. In the general panic, absent government intervention, the other banks would have gone down, too. Lenihan faced

## "THERE AREN'T ANY FOREIGN BUYERS [FOR IRISH REAL ESTATE]. THERE WERE NEVER ANY."

ers in the commercial-property market. He interviewed them, as a journalist might. On March 13, 2008, six months before the Irish real-estate Ponzi scheme collapsed, Ingram published a report, in which he simply quoted verbatim what British market insiders had told him about various banks' lending to commercial real estate. The Irish banks were making far riskier loans in Ireland than they were in Britain, but even in Britain, the report revealed, they were the nuttiest lenders around: in that category, Anglo Irish, Bank of Ireland, and A.I.B. came, in that order, first, second, and third.

For a few hours the Merrill Lynch report was the hottest read in the London financial markets, until Merrill Lynch retracted it. Merrill had been a lead underwriter of Anglo Irish's bonds and the corporate broker to A.I.B.: they'd earned huge sums of money off the growth of Irish banking. Moments after Phil Ingram hit the Send button on his report, the Irish banks called their Merrill Lynch bankers and threatened to take their business elsewhere. The same executive from Anglo Irish who had called to scream at Morgan Kelly called a Merrill research analyst to scream some more. Ingram's superiors at Merrill Lynch hauled him into meetings with

The Merrill Lynch memo listed a number of possible responses the Irish government might have to any run on Irish banks. It refrained from explicitly recommending one course of action over another, but its analysis of the problem implied that the most sensible thing to do was guarantee the banks. After all, the banks were fundamentally sound. Promise to eat all losses, and markets would quickly settle down—and the Irish banks would go back to being in perfectly good shape. As there would be no losses, the promise would be free.

What exactly was said in meetings on the night of September 29, 2008, remains, amazingly, something of a secret. The government has refused Freedom of Information Act-type requests for records. But gathered around the conference tables inside the prime minister's offices was an array of top government and finance officials, including Lenihan, Cowen, the attorney general, and bank officials and regulators. Eventually they brought in the heads of the two yet-to-be-disgraced big Irish banks: A.I.B. and Bank of Ireland. Evidently they either lied to Brian Lenihan about the extent of their losses or didn't know themselves what those were. Or both. "At the time they were all saying the same thing," an Irish

choice: Should he believe the people immediately around him or the financial markets? Should he trust the family or the experts? He stuck with the family. Ireland gave its promise. And the promise sank Ireland.

Even at the time, the decision seemed a bit odd. The Irish banks, like the big American banks, managed to persuade a lot of people that they were so intertwined with their economy that their failure would bring down a lot of other things, too. But they weren't, at least not all of them. Anglo Irish Bank had only six branches in Ireland, no A.T.M.'s, and no organic relationship with Irish business except the property developers. It lent money to people to buy land and build: that's practically all it did. It did this mainly with money it had borrowed from foreigners. It was not, by nature, systemic. It became so only when its losses were made everyone's.

In any case, if the Irish wanted to save their banks, why not guarantee just the deposits? There's a big difference between depositors and bondholders: depositors can flee. The immediate danger to the banks was that savers who had put money into them would take their money out, and the banks would be without funds. The investors who owned the roughly 80

billion euros of Irish bank bonds, on the other hand, were stuck. They couldn't take their money out of the bank. And their 80 billion euros very nearly exactly covered the eventual losses inside the Irish banks. These private bondholders didn't have any right to be made whole by the Irish government. The bondholders didn't even *expect* to be made whole by the Irish government. Not long ago I spoke with a former senior Merrill Lynch bond trader who, on September 29, 2008, owned a pile of bonds in one of the Irish banks. He'd already tried to sell them back to the bank for 50 cents on the dollar—that is, he'd offered to take a huge loss, just to get out of them. On the morning of September 30 he awakened to find his bonds worth 100 cents on the dollar. The Irish government had guaranteed

by rules rooted in English law, and under English law bondholders enjoy the same status as ordinary depositors. That is, it was against the law to protect the little people with deposits in the bank without also saving the big investors who owned Irish bank bonds.

This rings a bell. When U.S. Treasury secretary Hank Paulson realized that allowing Lehman Brothers to fail was viewed not as brave and principled but catastrophic, he, too, claimed he'd done what he'd done because the law gave him no other option. But in the heat of the crisis, Paulson had neglected to mention the law just as Lenihan didn't bring up the law requiring him to pay off the banks' private lenders until long after he'd done it. In both cases the explanation was

**A**cross Europe just now men who thought their title was "minister of finance" have woken up to the idea that their job is actually government bond salesman. The Irish bank losses have obviously bankrupted Ireland, but the Irish finance minister does not want to talk about that. Instead he mentions to me, several times, that Ireland is "fully funded" until next summer, which is to say that the Irish government has enough cash in the bank to pay its bills until next July. It isn't until I'm on my way out the door that I realize how trivial this point is. The blunt truth is that, since September 2008, Ireland has been, every day, more at the mercy of her creditors. To remain afloat, Ireland's biggest banks, which are now owned by the Irish government, have taken short-

## "IF YOU SAW [FORMER ALLIED IRISH C.E.O. EUGENE SHEEHY] NOW, YOU'D BUY HIM A CUP O' TEA."

them! He couldn't believe his luck. Across the financial markets this episode repeated itself. People who had made a private bet that went bad, and didn't expect to be repaid in full, were handed their money back—from the Irish taxpayer.

In retrospect, now that the Irish bank losses are known to be world-historically huge, the decision to cover them appears not merely odd but suicidal. A handful of Irish bankers incurred debts they could never repay, of something like 100 billion euros. They may have had no idea what they were doing, but they did it all the same. Their debts were private—owed by them to investors around the world—and still the Irish people have undertaken to repay them as if they were obligations of the state. For two years they have labored under this impossible burden with scarcely a peep of protest. What's more, all of the policy decisions since September 29, 2008, have set the hook more firmly inside the mouths of the Irish public. In January 2009 the Irish government nationalized Anglo Irish and its 34-billion-euro (and mounting) losses. In late 2009 they created the Irish version of the TARP program, but, unlike the U.S. government (which ended up buying stakes in the banks), they actually followed through on the plan and are in the process of buying 70 billion euros of crappy assets from the Irish banks.

**A** single decision sank Ireland, but when I ask Lenihan about it he becomes impatient, as if it isn't a fit topic for conversation. It wasn't much of a decision, he says, as he had no choice. The Irish financial markets are governed

legalistic: narrowly true, but generally false. The Irish government always had the power to impose losses on even the senior bondholders, if it wanted to. "Senior people have forgotten that the government has certain powers," as Morgan Kelly puts it. "You can conscript people. You can send them off to certain death. *You can change the law.*"

On September 30, 2008, in the heat of the moment, Lenihan gave the same reason for guaranteeing the banks' debts that Merrill Lynch had given him: to prevent "contagion." Tell financial markets that a loan to an Irish bank was a loan to the Irish government and investors would calm down. For who would doubt the credit of the government? A year and a half later, when suspicions arose that the banks' losses were so vast they might bankrupt the government, Lenihan offered a new reason for the government's gift to private investors: the bonds were owned by Irishmen. Up until then the government's line had been that they had no idea who owned the bank's bonds. Now they said that, if the Irish government didn't eat the losses, Irish credit unions and insurance companies would pay the price. The Irish, in other words, were simply saving the Irish. This wasn't true, and it provoked a cry of outrage from the credit unions, which said that they owned hardly any of the bonds. A political investigative blog called Guido Fawkes somehow obtained a list of the Anglo Irish foreign bondholders: German banks, French banks, German investment funds, Goldman Sachs. (Yes! Even the Irish did their bit for Goldman.)

term loans from the European Central Bank amounting to 86 billion euros. Two weeks later Lenihan will be compelled by the European Union to invite the I.M.F. into Ireland, relinquish control of Irish finances, and accept a bailout package. The Irish public doesn't yet know it, but, even as we sit together at his conference table, the European Central Bank has lost interest in lending to Irish banks. And soon Brian Lenihan will stand up in the Irish Parliament and offer a fourth explanation for why private investors in Ireland's banks cannot be allowed to take losses. "There is simply no way that this country, whose banks are so dependent on international investors, can unilaterally renege on senior bondholders against the wishes of the E.C.B.," he will say.

But there was once a time when the wishes of the E.C.B. didn't matter to Ireland. That time was before the Irish government used E.C.B. money to pay off the foreign bondholders in Irish banks.

### Bring Me a Little Ire

**O**nce a decade I experiment with driving on the wrong side of the road, and wind up destroying dozens of side-view mirrors on cars parked on the left. When I went looking for some Irish person to drive me around, the result was a fellow I will call Ian McRory (he asked me not to use his real name in this article), who is Irish, and a driver, but pretty clearly a lot of other things, too. Ian has what appears to be a military-grade navigational system, for instance, and surprising knowledge about abstruse and secretive matters. "I do some personal se-

curity, and things of that nature,” he says, when I ask him what else he does other than drive financial-disaster tourists back and forth across Ireland, and leaves it at that. Later, when I mention the name of a formerly rich Irish property developer, he says, casually, as if it were all in a day’s work, that he had let himself into the fellow’s vacation house and snapped photographs of the interior, “for a man I know who is thinking of buying it.”

Ian turns out to have a good feel for what I, or anyone else, might find interesting in rural Ireland. He will say, for example, “Over there, that’s a pretty typical fairy ring,” and then explain, interestingly, that these circles of stones or mushrooms that occur in Irish fields are believed by local farmers to house mythical creatures. “Irish people actually believe in fairies?,” I ask, straining but failing to catch a glimpse of the typical fairy ring to which Ian has just pointed. “I mean, if you walked right up and asked him to his face, ‘Do you believe in fairies?’ most guys will deny it,” he replies. “But if you ask him to dig out the fairy ring on his property, he won’t do it. To my way of thinking, that’s believing.” And it is. It’s a tactical belief, a belief

Randomly selecting a village that appears to be more or less finished, we pull off the road. It’s an exurb, without a suburb. GLEANN RIADA, reads the self-important sign in front. It’s a few dozen houses in a field, attached to nothing but each other, ending with unoccupied slabs of concrete buried in weeds. You can see the moment the money stopped flowing from the Irish banks, the developer folded his tent, and the Polish workers went home. “The guys who laid this didn’t even believe it was supposed to be finished,” says Ian. The concrete slab, like the completed houses, is riven by the kind of cracks you see in a house after a major earthquake, but in this case are caused by carelessness. Inside, the floors are littered with trash and debris, the fixtures have been ripped out of the kitchen, and mold spreads spider-like across the walls. The last time I saw an interior like this was in New Orleans after Katrina.

**I**n October, Ireland’s Department of the Environment published its first audit of the country’s new housing stock after inspecting 2,846 housing developments, many of them called “ghost estates” because they’re empty. Of the nearly 180,000

**W**hich way entire nations jumped when the money was made freely available to them obviously told you a lot about them: their desires, their constraints, their secret sense of themselves. How they reacted when the money was taken away was equally revealing. In Greece the money was borrowed by the state: the debts are the debts of the Greek people, but the people want no part of them. The Greeks already have taken to the streets, violently, and have been quick to find people other than themselves to blame for their problems: monks, Turks, foreign bankers. Greek anarchists now mail bombs to Angela Merkel and hurl Molotov cocktails at their own police. In Ireland the money was borrowed by a few banks, and yet the people seem not only willing to repay it but to do so without a peep of protest. Back in October 2008, after the government threatened to mean-test for medical care, the old people marched in the streets of Dublin. A few days after I’d arrived the students followed suit, but their protest was less public anger than theater, and perhaps an excuse to skip school. (DOWN WITH THIS SORT OF THING, read one of the students’

## IN SOME NEW AND STRANGE WAY DUBLIN IS NOW AN OCCUPIED CITY: HANOI, 1950.

that exists because the upside to disbelief is too small, like the former Irish belief that Irish land prices would rise forever.

**T**he highway out of Dublin runs past abandoned building sites and neighborhoods without people in them. “We can stop at ghost estates on the way,” says Ian, as we clear the suburbs of Dublin. “But if we stop at every one of them, we’ll never get out of here.”

We pass wet green fields carved by potato farmers into small plots, and every now and then a small village, but even the inhabited places feel desolate. The Irish countryside remains a place people flee. Among its drawbacks, from the outsider’s point of view, is the weather. “It’s always either raining or about to rain,” says Ian. “I drove a black guy from Africa around the country once. It’s raining the whole time. He says to me, ‘I don’t know why people live here. It’s like living under an elephant.’”

The wet hedgerows cultivated along the highway to hide the wet road from the wet houses now hide the wet houses from the wet road. PICTURE OF THE VILLAGE OF THE FUTURE, reads a dripping billboard with a picture of a village that will never be built.

units that had been granted planning permission, the audit found that only 78,195 were completed and occupied. Others are occupied but remain unfinished. Virtually all construction has now ceased. There aren’t enough people in Ireland to fill the new houses; there were never enough people in Ireland to fill the new houses. Ask Irish property developers who they imagined was going to live in the Irish countryside, and they all laugh the same uneasy laugh and offer up the same list of prospects: Poles; foreigners looking for second homes; entire departments of Irish government workers, who would be shipped to the sticks in a massive, planned relocation that somehow never materialized; the diaspora of 70 million human beings with a genetic link to Ireland. The problem that no one paid all that much attention to during the boom was that people from outside Ireland, even those with a genetic link to the place, have no interest in owning houses there. “This isn’t an international property market,” says an agent at Savills’s Dublin branch named Ronan O’Driscoll. “There aren’t any foreign buyers. There were never foreign buyers.” Dublin was never London. The Irish countryside will never be the Cotswolds.

signs.) I’d tapped two students as they stumbled away from the event to ask why they had all painted yellow streaks on their faces. They looked at each other for a beat. “Dunno!” one finally said and burst out laughing. Other than that . . . silence. It’s more than two years since the Irish government foisted the losses of the Irish banks on the Irish people, and in that time there have been only two conspicuous acts of social unrest. In May 2009, at A.I.B.’s first shareholder meeting after the collapse, a senior citizen hurled rotten eggs at the bank’s executives. And early one morning in September 2010, a 41-year-old property developer from Galway named Joe McNamara, who had painted his cement mixer with anti-banker slogans, climbed inside the cab, drove through Dublin, and, after cutting the brake lines, stalled the machine up against the gates of the Parliament. The elderly egg thrower was a distant memory, but McNamara was still, more or less, in the news: declining requests for interviews. “Joe is a private person,” his lawyer told me. “He feels like he’s made his point. He doesn’t want any media attention.”

Before he’d parked his cement mixer in the Parliament’s driveway, McNamara

had been a small-time builder. He'd started out laying foundations, and like a lot of rural tradesmen, he'd been given a loan by the Anglo Irish Bank. Thus began his career as a property developer. He'd moved to Galway, into a tacky new development beside a golf course, but the real source of his financial distress lay an hour or so beyond the city, in a resort hotel he'd tried to build on a remote island called Achill, in the tiny village in which he'd grown up, called Keel. "Achill," says Ian after I tell him that's where I'd like to go, then goes silent for a minute, as if

receivership. Irish bankruptcy laws were not designed for spectacular failure, perhaps because the people who wrote them never imagined spectacular success. When a bank forces an Irish person into receivership, a notice is published in a national and a local newspaper—ensuring the bankrupt's widespread shame. For as many as 12 years the person is not permitted to take out a loan for more than 650 euros without disclosing his bankruptcy status or own assets amounting to more than 3,100 euros, and part of whatever he earns may pass to his creditors at

Ireland's National Asset Management Agency (its TARP) controls roughly 70 billion euros of commercial-property loans. It is believed that smaller Irish property-related loans amount to another 85 billion euros. Some very large number of Irish former tradesmen are in exactly Joe McNamara's situation. Some very large number of Irish *homeowners* are in something very like it.

The difference between McNamara and everyone else is that he complained about it publicly. But then, apparently, thought better of it. I'd tracked down and

## "I COLLECTED BOTTLES. NOW THE HEALTH SERVICE DOESN'T BOTHER TO TAKE BACK CRUTCHES?"

giving me time to reconsider. "This time of year Achill's going to be fairly bleak." He thinks another minute. "Mind you, in the summer it can be fairly bleak as well."

It's twilight as we roll across the tiny bridge and onto the island. On either side of the snaking single-lane road peat bogs stretch as far as the eye can see. The feel is less "tourist destination" than "end of the earth." ("The next stop is Newfoundland," says Ian.) The Achill Head Hotel—Joe's first venture, still run by his ex-wife—was closed and dark. But there, smack in the middle of the tiny village of Keel, was the source of all of Joe McNamara's financial troubles: a giant black hole, surrounded by bulldozers and building materials. He'd set out in 2005 to build a modest one-story hotel, with 12 rooms. In April 2006, with the Irish property market exploding, he'd expanded his ambition and applied for permission to build a multi-story luxury hotel. At exactly that moment, the market turned. "We went away in June of 2006," Ronan O'Driscoll, the Savills broker, had told me. "We came back in September and everything had just stopped. How does everyone decide at once that it is time to stop—that it's become mad?" For the past four years the hotel's site had scarred the village. But it wasn't until early 2010 that Anglo Irish Bank, which had lent McNamara the money to develop it, threatened to force him into

the discretion of the court. "It's not like the United States, where being bankrupt is almost a badge of honor," says Patrick White, of the Irish Property Council. "Here you are effectively disbarred from commercial life."

There is an ancient rule of financial life—that if you owe the bank five *million* bucks the bank owns you, but if you owe the bank five *billion* bucks you own the bank—that newly applies to Ireland. The debts of its big property developers—now generally defined as anyone who owed the bank more than 20 million euros—are being worked out behind closed doors. In exchange for helping the government to manage or liquidate their real-estate portfolios, the biggest failures are hoping to be spared bankruptcy. Smaller developers, like McNamara, are in a far harder place, and while no one seems to know how many of these people exist, the number is clearly big.

phoned his ex-wife, who just laughed and told me to get lost. I finally reached McNamara himself, ambushing him on his cell phone. But he just muttered something about not wanting to draw further attention to himself, then hung up. It was only after I texted him to say I was en route to his hometown that he became sufficiently aroused to communicate. "What are you doing in Keel???" he hollered by text message, more than once. "Tell me *Why are you going to Keel???*" Then, once again, he fell silent. "The problem with the Irish people," Ian says, as we drive away from the black hole that ruined Joe McNamara, "is that you can push them and push them and push them. But when they break they go wacko." A month later, after a period of silence, McNamara would reappear, blasting the theme from *The Good, the Bad and the Ugly* from the top of a cherry-picker crane that he had parked, once again, in front of the Parliament.

Two things strike every Irish person when he comes to America, Irish friends tell me: the vastness of the country, and the seemingly endless desire of its people to talk about their personal problems. Two things strike an American when he comes to Ireland: how small it is and how tight-lipped. An Irish person with a personal problem takes it into a hole with him, like a squirrel with a nut before winter. He tortures himself and sometimes his loved ones too. What



### MEN OF ACTION

Left, Joe McNamara leaves Dublin District Court, September 2010. Right, Gary Keogh, who threw rotten eggs at A.I.B. executives.

he doesn't do, if he has suffered some reversal, is vent about it to the outside world. The famous Irish gift of gab is a cover for all the things they aren't telling you.

So far as I could see, by November 10, 2010, the population of Irish people willing to make a stink about what has happened to them has been reduced to one: the elderly egg thrower. The next day we pull up outside his home, a modest old semi-detached house on the outskirts of Dublin. The cheery gentleman who opens the door in a neat burgundy sweater and well-pressed slacks has, among his other qualities, fantastically good manners. He has the ability to seem pleased even when total strangers ring his doorbell, and to make them feel welcome. On the table in Gary Keogh's small and tidy dining room is a book, created by his grandchildren, dated May 2009, called "Granddad's Eggcellent Adventure."

In the months after Lenihan's bank bailout, Keogh began to pay attention to the behavior of Irish bankers. His own shares in A.I.B., once thought to be as sound as cash or gold, were rapidly becoming worthless. But the bank's executives exhibited not the first hint of remorse or shame. A.I.B. chairman Dermot Gleeson and C.E.O. Eugene Sheehy troubled Keogh the most. "The two of 'em stood up, time and again, and said, 'Our bank is

100 percent sound,'" he says. "As if nothing at all was the matter!" He set out to learn more about these people in whom he had always placed blind trust. And what he found—high pay, corporate boondoggles—outraged him further. "The chairman paid himself 475,000 [euros] to chair 12 meetings!" Keogh still shouts.

What Keogh learned remains both the most shocking and the most familiar aspect of the Irish catastrophe: how easily ancient financial institutions abandoned their traditions and principles. An upstart bank, Anglo Irish, had entered their market and professed to have found a new and better way to be a banker. Anglo Irish made incredibly quick decisions: an Irish property developer who was an existing client could walk into its office in the late afternoon with a new idea and walk out with a commitment of hundreds of millions of euros that night. Anglo Irish was able to shovel money out its door so quickly because it had turned banking into a family affair: if they liked the man, they didn't bother to evaluate his project.

Rather than point out the insanity of the approach, the two old Irish banks simply caved to it. An Irish businessman named Denis O'Brien sat on the board of the Bank of Ireland in 2005, when it was

faced with the astonishing growth of Anglo Irish, which was about to *double* in size in just two years. "I remember the C.E.O. coming in and saying, 'We're going to grow at 30 percent a year,'" O'Brien tells me. "I said, How the fuck are you going to do that? Banking is a 5-to-7-percent-a-year-growth business at best."

They did it by doing what Anglo Irish had done: writing checks to Irish property developers to buy Irish land at any price. A.I.B. even opened a unit dedicated to poaching Anglo's biggest property-developer clients—the very people who would become the most spectacular busts in Irish history. In October 2008, the *Irish Independent* published a list of the five biggest real-estate deals in each of the past three years. A.I.B. lent the money for 6 of the 15, Anglo Irish for just 1, as a co-lender with A.I.B. On Irish national radio recently, the insolvent property developer Simon Kelly, whose family's real-estate portfolio has run up bad debts of 2 billion euros, confessed that the only time in his career a banker became upset with him was when he *repaid* a loan, to Anglo Irish, with money borrowed from A.I.B. The former Anglo Irish executives I interviewed (off

@vf.com

Q&A: MICHAEL LEWIS DISCUSSES HIS EVENTFUL IRISH SOJOURN.

the record, as they are all in hiding) speak of their older, more respectable imitators with a kind of amazement. “Yes, we were out of control,” they say, in so many words. “But those guys were *fucking nuts*.”

**G**ary Keogh thought about how Ireland had changed from his youth, when the country was dirt-poor. “I used to collect bottles. Now the health service doesn’t even bother to take back crutches anymore? No! We’re far too wealthy.”

Unlike most people he knew, he had no debts. “I had nothing to lose,” he says. “I didn’t owe anyone any money. That’s why I could do it!” He’d also just recovered from a serious illness, and so, emotionally, felt a bit as if he were playing with house money. “I had just got a new kidney and I was very pleased with it,” he says. “But I think it must have been Che Guevara’s kidney.” He describes his elaborate plot the way an assassin might describe the perfect hit. “I only had two rotten eggs,” he says, “but by God they were rotten! Because I kept them six weeks in the garage!”

**T**he A.I.B. shareholders’ meeting of May 2009 was the first he’d ever attended. He was, he admits, a bit worried something might go wrong. Worried that parking might be a prob-

lem, he took the bus; worried that his eggs might break, he used a container to protect them; worried that he didn’t even know what the room looked like, he left himself time to case the meeting hall. “I got to the front door early and had a little recce,” as he puts it, “just to see what was going to happen.” His egg container was too large to sneak inside, so he ditched it. “I had one egg in each jacket pocket,” he says. Worried that his eggs might be too slippery to grip and throw, he’d put Band-Aids on them. “I positioned myself four rows back and four seats in,” he says. “Not too close but not too far.” Then he waited for his moment.

It came immediately. Right after the executives took their places at the dais, a shareholder stood up, uninvited, with a point of order. Gleeson, A.I.B.’s chairman, barked, “Sit down!”

“He thought he was a dictator!” says Keogh, who had heard enough.

He rose to his feet and shouted, “I’ve listened to enough of your crap! You’re a fucking git!” And then he began firing.

“He thought he had been shot,” he says now with a little smile, “because the first egg hit the microphone and went *POW!*” It splattered onto the shoulder pad of Gleeson’s suit. The second egg missed the

C.E.O. but nailed the A.I.B. sign behind him.

Then the security guards were on him. “I was told I would be arrested and charged, but I never was,” he says. Of course he wasn’t: this was at bottom a family dispute. The guards wanted to escort him out, but he left the place on his own and climbed aboard the next bus home. “The incident happened at 10 past 10 in the morning,” he says. “I was home by 10 to 11. At 10 past 11 the phone rang. And I was on the radio for an hour.” Then, but briefly, all was madness. “The press descended on the house and they wouldn’t get out,” he says. It didn’t really matter; he wasn’t sticking around. He’d done exactly what he’d planned to do, and saw no need to make a further fuss. He flew out of Dublin Airport at seven the next morning, for a long-planned Mediterranean cruise. □

---

---

## FROM THE ARCHIVE

*For these related stories, visit [VF.COM/ARCHIVE](http://VF.COM/ARCHIVE)*

- **Euro DisasterLand, Part I: Iceland**  
*(Michael Lewis, April 2009)*
- **Euro DisasterLand, Part II: Greece**  
*(Michael Lewis, October 2010)*
- **A selection from *The Big Short: Inside the doomsday machine***  
*(Michael Lewis, April 2010)*

# It's the Econom

## WURST-CASE SCENARIO

German deputy finance minister Jörg Asmussen, at a vestige of the Berlin Wall.

# y, Dummkopf!

With Greece and Ireland in economic shreds, while Portugal, Spain, and perhaps even Italy head south, only one nation can save Europe from financial Armageddon: a highly reluctant Germany. The ironies—like the fact that bankers from Düsseldorf were the ultimate patsies in Wall Street's con game—pile up quickly as MICHAEL LEWIS investigates German attitudes toward money, excrement, and the country's Nazi past, all of which help explain its peculiar new status

---

# B

By the time I arrived in Hamburg the fate of the financial universe seemed to turn on which way the German people jumped. Moody's was set to downgrade the Portuguese government's debt to junk-bond status, and Standard & Poor's had hinted darkly that Italy might be next. Ireland was about to be downgraded to junk status, too, and there was a very real possibility that the newly elected Spanish government might seize the moment to announce that the old Spanish government had miscalculated, and owed foreigners a lot more money than they previously imagined. Then there was Greece. Of the 126 countries with rated debt, Greece now ranked 126th: the Greeks were officially regarded as the least likely people on the planet to repay their debts. As the Germans were not only the biggest creditor of the various deadbeat European nations but their only serious hope for future funding, it was left to Germans to act as moral arbiter, to decide which financial behaviors would be tolerated and which would not. As a senior official at the Bundesbank put it to me, "If we say 'no,' it's 'no.' Nothing happens without Germany. This is where the losses come to live." Just a year ago, when German public figures called Greeks cheaters, and German magazines ran headlines like WHY DON'T YOU SELL YOUR ISLANDS, YOU BANKRUPT GREEKS?, ordinary Greeks took it as an outrageous insult. In June of this year the Greek government started selling islands or at any rate created a fire-sale list of a thousand properties—golf courses, beaches, airports, farmlands, roads—that they hoped to sell, to help repay their debts. It was safe to say that the idea for doing this had not come from the Greeks.

To no one but a German is Hamburg an obvious place to spend a vacation, but it happened to be a German holiday, and Hamburg was overrun by German tourists. When I asked the hotel concierge what there was to

see in his city, he had to think for a few seconds before he said, "Most people just go to the Reeperbahn." The Reeperbahn is Hamburg's red-light district, the largest red-light district in Europe, according to one guidebook, though you have to wonder how anyone figured that out. And the Reeperbahn, as it happens, was why I was there.

Perhaps because they have such a gift for creating difficulties with non-Germans, the Germans have been on the receiving end of many scholarly attempts to understand their collective behavior. In this vast and growing enterprise, a small book with a funny title towers over many larger, more ponderous ones. Published in 1984 by a distinguished anthropologist named Alan Dundes, *Life Is Like a Chicken Coop Ladder* set out to describe the German character through the stories that ordinary Germans liked to tell one another. Dundes specialized in folklore, and in German folklore, as he put it, "one finds an inordinate number of texts concerned with anality. Scheisse (shit), Dreck (dirt), Mist (manure), Arsch (ass)... Folksongs, folktales, proverbs, riddles, folk speech—all attest to the Germans' longstanding special interest in this area of human activity."

He then proceeded to pile up a shockingly high stack of evidence to support his theory. There's a popular German folk character called der Dukatenscheisser ("The Money Shitter"), who is commonly depicted crapping coins from his rear end. Europe's only museum devoted exclusively to toilets was built in Munich. The German word for "shit" performs a vast number of bizarre linguistic duties—for instance, a common German term of endearment was once "my little shit bag." The first thing Gutenberg sought to publish, after the Bible, was a laxative timetable he called a "Purgation-Calendar." Then there are the astonishing number of anal German folk sayings: "As the fish lives in water, so does the shit stick to the asshole!" to select but one of the seemingly endless examples.

Dundes caused a bit of a stir, for an anthropologist, by tracking this single low national character trait into the most important moments in German history. The fiercely scatological Martin Luther ("I am like ripe shit, and the world is a gigantic asshole," Luther once explained) had the idea that launched the Protestant Reformation while sitting on the john. Mozart's letters revealed a mind, as Dundes put it, whose "indulgence in fecal imagery may be virtually unmatched." One of Hitler's favorite words was *Scheisskerl* ("shithead"); he apparently used it to describe not only other people but himself as well. After the war, Hitler's doctors told U.S. intelligence officers that their patient had devoted surprising energy to ex-

aming his own feces, and there was pretty strong evidence that one of his favorite things to do with women was to have them poop on him. Perhaps Hitler was so persuasive to Germans, Dundes suggested, because he shared their quintessential trait, a public abhorrence of filth that masked a private obsession. "The combination of clean and dirty: clean exterior—dirty interior, or clean form and dirty content—is very much a part of the German national character," he wrote.

The anthropologist confined himself mainly to a study of low German culture. (For those hoping to examine coprophilia in German high culture he recommended another book, by a pair of German scholars, entitled *The Call of Human Nature: The Role of Scatology in Modern German Literature*.) Still, it was hard to come away from his treatise without the strong sense that all Germans, high and low, were a bit different from you and me—a point he made in the introduction to the paperback version of his book. "The American wife of a German-born colleague confessed to me that she understood her husband much better after reading the book," he wrote. "Prior to that time, she had wrongly assumed that he must have some kind of peculiar psychological hang-up inasmuch as he insisted upon discussing at great length the state of his latest bowel movements."

The Hamburg red-light district had caught Dundes's eye because the locals made such a big deal of mud-wrestling. Naked women fought in a metaphorical ring of filth while the spectators wore plastic caps, a sort of head condom, to avoid being splattered. "Thus," wrote Dundes, "the audience can remain clean while enjoying dirt!" Germans longed to be near the shit, but not in it. This, as it turns out, was an excellent description of their role in the current financial crisis.

### The Scheisse Hits the Fan

A week or so earlier, in Berlin, I had gone to see Germany's deputy minister of finance, a 44-year-old career government official named Jörg Asmussen. The Germans are now in possession of the only Finance Ministry in the big-time developed world whose leaders don't need to worry whether their economy will collapse the moment investors stop buying their bonds. As unemployment in Greece climbs to the highest on record (16.2 percent at last count), it falls in Germany to 20-year lows (6.9 percent). Germany appears to have experienced a financial crisis without economic consequences. They'd donned head condoms in the presence of their bankers,

and so they had avoided being splattered by their mud. As a result, for the past year or so the financial markets have been trying and failing to get a bead on the German people: they can probably afford to pay off the debts of their fellow Europeans, but will they actually do it? Are they now Europeans, or are they still Germans? Any utterance or gesture by any German official anywhere near this decision for the past 18 months has been a market-moving headline, and there have been plenty, most of them echoing German public opinion, and expressing incomprehension and outrage that other peoples can behave so irresponsibly. Asmussen is one of the Germans now being obsessively watched. He and his boss, Wolfgang Schäuble, are the two German officials present in every conversation between the German government and the deadbeats.

The Finance Ministry, built in the mid-

but by choice rather than circumstance. Extremely fit white men who shave their heads are making a statement, in my experience of them. “I don’t need body fat and I don’t need hair,” they seem to be saying, while also implying that anyone who does is a wuss. The deputy finance minister even laughs just as all extremely fit men with shaved heads should laugh, if they want to remain in character. Instead of opening his mouth to allow the air to pass he purses his lips and snorts the sound out through his nose. He may need laughter as much as other men, but he needs less air to laugh with. His desk is a template of self-discipline. It is alive with implied activity—legal pads, Post-it notes, manila folders—but every single object on it is perfectly aligned with all the others, and with the edges of the desk. Every angle is precisely 90 degrees. But the most striking optional décor is a

a similar job in Germany pays 55,000 euros. In Greece it is 70,000.” To get around pay restraints in the calendar year the Greek government simply paid employees a 13th and even 14th monthly salary—months that didn’t exist. “There needs to be a change of the relationship between people and the government,” he continues. “It is not a task that can be done in three months. You need time.” He couldn’t put it more bluntly: if the Greeks and the Germans are to coexist in a currency union, the Greeks need to change who they are.

**T**his is unlikely to happen soon enough to matter. The Greeks not only have massive debts but are still running big deficits. Trapped by an artificially strong currency, they cannot turn these deficits into

## “IF WE SAY ‘NO,’ IT’S ‘NO,’” A BUNDESBANK OFFICIAL SAYS. “NOTHING HAPPENS WITHOUT GERMANY. THIS IS WHERE THE LOSSES COME TO LIVE.”

1930s, is a monument to both the Nazis’ ambition and their taste. A faceless butte, it is so big that if you circle it in the wrong direction it can take you 20 minutes to find the front door. I circle it in the wrong direction, then sweat and huff to make up for lost time, all the while wondering if provincial Nazis in from the sticks had had the same experience, wandering outside these forbidding stone walls and trying to figure out how to get in. At length I find a familiar-looking courtyard: the only difference between it and famous old photographs of it is that Hitler is no longer marching in and out of the front door, and the statues of eagles perched atop swastikas have been removed. “It was built for Göring’s Air Ministry,” says the waiting Finance Ministry public-relations man, who is, oddly enough, French. “You can tell from the cheerful architecture.” He then explains that the building is so big because Hermann Göring wanted to be able to land planes on its roof.

**I** have arrived about three minutes late, but the German deputy minister of finance runs a full five minutes later, which, I will learn, is viewed by Germans almost as a felony. He apologizes a lot more than he needs to for the delay. He wears the slender-framed spectacles of a German film director, and is extremely fit and bald,

big white sign on the wall beside the desk. It’s in German but translates easily back into the original English:

THE SECRET OF SUCCESS IS TO UNDERSTAND  
THE POINT OF VIEW OF OTHERS.

—HENRY FORD

This surprises me. It’s not at all what an extremely fit bald man should have as his mantra. It’s *soft*. The deputy finance minister further disturbs my wild assumptions about him by speaking clearly, even recklessly, about subjects most finance ministers believe it is their job to obscure. He offers up, without much prompting, that he has just finished reading the latest unpublished report by I.M.F. investigators on the progress made by the Greek government in reforming itself.

“They have not sufficiently implemented the measures they have promised to implement,” he says simply. “And they have a massive problem still with revenue collection. Not with the tax law itself. It’s the collection which needs to be overhauled.”

Greeks are still refusing to pay their taxes, in other words. But it is only one of many Greek sins. “They are also having a problem with the structural reform. Their labor market is changing—but not as fast as it needs to,” he continues. “Due to the developments in the last 10 years,

surpluses, even if they do everything that outsiders ask them to do. Their exports, priced in euros, remain expensive. The German government wants the Greeks to slash the size of their government, but that will also slow economic growth and reduce tax revenues. And so one of two things must happen. Either Germans must agree to a new system in which they would be fiscally integrated with other European countries as Indiana is integrated with Mississippi: the tax dollars of ordinary Germans would go into a common coffer and be used to pay for the lifestyle of ordinary Greeks. Or the Greeks (and probably, eventually, every non-German) must introduce “structural reform,” a euphemism for magically and radically transforming themselves into a people as efficient and productive as the Germans. The first solution is pleasant for Greeks but painful for Germans. The second solution is pleasant for Germans but painful, even suicidal, for Greeks.

The only economically plausible scenario is that Germans, with a bit of help from a rapidly shrinking population of solvent European countries, suck it up, work harder, and pay for everyone else. But what is economically plausible appears to be politically unacceptable. The German people all know at least one fact about the euro: that before they agreed to trade in

their deutsche marks their leaders promised them, explicitly, they would never be required to bail out other countries. That rule was created with the founding of the European Central Bank (E.C.B.)—and was violated a year ago. The German public is every day more upset by the violation—so upset that Chancellor Angela Merkel, who has a reputation for reading the public mood, hasn't even bothered to try to go before the German people to persuade them that it might be in their interests to help the Greeks.

That is why Europe's money problems feel not just problematic but intractable. It's why Greeks are now mailing bombs to Merkel, and thugs in Berlin are hurling stones through the window of the Greek consulate. And it's why European leaders have done nothing but delay the inevitable reckoning, by scrambling every few months to find cash to plug the ever growing economic holes

in Greece and Ireland and Portugal and praying that even bigger and more alarming holes in Spain, Italy, and even France refrain from revealing themselves.

Until now the European Central Bank, in Frankfurt, has been the main source of this cash. The E.C.B. was designed to behave with the same discipline as the German Bundesbank, but it has morphed into something very different. Since the start of the financial crisis it has bought, outright, something like \$80 billion of Greek and Irish and Portuguese government bonds, and lent another \$450 billion or so to various European governments and European banks, accepting virtually any collateral, including Greek government bonds. But the E.C.B. has a rule—and the Germans think the rule very

important—that they cannot accept as collateral bonds classified by the U.S. ratings agencies as in default. Given that they once had a rule against buying bonds outright in the open market, and another rule against government bailouts, it's a little odd that they have gotten so hung up on this technicality. But they have. If Greece defaults on its debt, the E.C.B. will not only lose a pile on its holdings of Greek bonds but must return the bonds to the European banks, and the European banks must fork over \$450 billion in cash. The E.C.B. itself might face insolvency, which would mean turning for funds to its solvent member governments, led by Germany. (The senior official at the Bundesbank told me they already have thought about how to deal with the request. "We have 3,400 tons of gold," he said. "We are the only country that has not sold its original allotment from the [late 1940s]. So we are covered to some extent.") The bigger problem with a Greek default is that it might well force other European countries and their banks into default. At the very least it would create panic and confusion in the market for both sovereign and bank debt, at a time when a lot of banks and at least two big European debt-ridden countries, Italy and Spain, cannot afford panic and confusion.

At the bottom of this unholy mess, from the point of view of the German Finance Ministry, is the unwillingness, or inability, of the Greeks to change their behavior.

That was what the currency union always implied: entire peoples had to change their ways of life. Conceived as a tool for integrating Germany into Europe, and preventing Germans from dominating others, it has become the opposite. For better or for worse, the Germans now own Europe. If the rest of Europe is to continue to enjoy the benefits of what is essentially a German currency, they need to become more German. And so, once again, all sorts of people who would rather not think about what it means to be "German" are compelled to do so.

Jörg Asmussen offers the first hint of an answer—in his personal behavior. He is a type familiar in Germany but absolutely freakish in Greece—or for that matter the United States: a keenly intelligent, highly ambitious civil servant who has no other desire but to serve his country. His sparkling curriculum vitae is missing a line that would be found on the résumés of men in his position most anywhere else in the world—the line where he leaves government service for Goldman Sachs to cash out. When I asked another prominent German civil servant why he hadn't taken time out of public service to make his fortune working for some bank, the way every American



#### EURO TRASHED?

Economist Henrik Enderlein in front of the German Parliament building, in Berlin. Opposite, Wilhelm Nölling, an economist who opposed the euro in 1998, at his farm outside Hamburg.



## “GERMANS ARE BY AND LARGE GULLIBLE PEOPLE,” SAYS NÖLLING. “THEY TRUST AND BELIEVE. THEY *LIKE* TO TRUST. THEY *LIKE* TO BELIEVE.”

civil servant who is anywhere near finance seems to want to do, his expression changed to alarm. “But I could never do this,” he said. “It would be illoyal!”

Asmussen agrees and then addresses the German question more directly. The curious thing about the eruption of cheap and indiscriminate lending of money during the past decade was the different effects it had from country to country. Every developed country was subjected to more or less the same temptation, but no two countries responded in precisely the same way. The rest of Europe, in effect, used Germany’s credit rating to indulge its material desires. They borrowed as cheaply as Germans could to buy stuff they couldn’t afford. Given the chance to take something for nothing, the German people alone simply ignored the offer. “There was no credit boom in Germany,” says Asmussen. “Real-estate prices were completely flat. There was no borrow-

ing for consumption. Because this behavior is rather alien to Germans. Germans save whenever possible. This is deeply in German genes. Perhaps a leftover of the collective memory of the Great Depression and the hyperinflation of the 1920s.” The German government was equally prudent because, he went on, “there is a consensus among the different parties about this: if you’re not adhering to fiscal responsibility, you have no chance in elections, because the people are that way.”

**I**n that moment of temptation, Germany became something like a mirror image of Iceland and Ireland and Greece and, for that matter, the United States. 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.

This is what makes the German case so peculiar. If they had been merely the only big, developed nation with decent financial morals, they would present one sort of picture, of simple rectitude. But they had done something far more peculiar: during the boom German bankers had gone out of their way to get dirty. They lent money to American subprime borrowers, to Irish real-estate barons, to Icelandic banking tycoons to do things that no German would ever do. The German losses are still being toted up, but at last count they stand at \$21 billion in the Icelandic banks, \$100 billion in Irish banks, \$60 billion in various U.S. subprime-backed bonds, and some yet-to-be-determined amount in Greek bonds. The only financial disaster in the last decade German bankers appear to have missed was investing with Bernie Madoff. (Perhaps the only advantage to the German financial system of having no Jews.) In

their own country, however, these seemingly crazed bankers behaved with restraint. The German people did not allow them to behave otherwise. It was another case of clean on the outside, dirty on the inside. The German banks that wanted to get a little dirty needed to go abroad to do it.

About this the deputy finance minister has not that much to say. He continues to wonder how a real-estate crisis in Florida could end with all these losses in Germany.

**A** German economist named Henrik Enderlein, who teaches at the Hertie School of Governance, in Berlin, has described the radical change that occurred in German banks beginning about 2003. In a paper in progress, Enderlein points out that “many observers initially believed German banks would be relatively less exposed to the crisis. The contrary turned out to be the case. German banks ended up being among the most severely affected in continental Europe and this despite relatively favorable economic conditions.” Everyone thought that German bankers were more conservative, and more isolated from the outside world, than, say,

the German banks. “They are playing billiards,” says Enderlein. “The easier way to do it would be to give German money to the German banks and let the Irish banks fail.” Why they don’t simply do this is a question worth trying to answer.

The 20-minute walk from the German Finance Ministry to the office of the chairman of Commerzbank, one of Germany’s two giant private banks, is punctuated by officially sanctioned memories: the new Holocaust Memorial, two and a half times the acreage occupied by the U.S. Embassy; the new street beside it, called Hannah Arendt Street; the signs pointing to Berlin’s new Jewish Museum; the park that contains the Berlin Zoo, where, after spending decades denying they had ever mistreated Jews, they have newly installed, on the Antelope House, a plaque acknowledging their Nazi-era expropriation of shares in the zoo owned by Jews. Along the way you also pass Hitler’s bunker, but you’d never know it was there, as it has been paved over for a parking lot, and the small plaque that commemorates it is well hidden.

The streets of Berlin can feel like an elaborate shrine to German guilt. It’s as if the Germans have been required to accept that they will always play the villain.

He already held one European passport, but he worried that the European Union might one day fall apart, and he wanted access to Germany, just in case. The German official in charge—an Aryan out of central casting, wearing a Teutonic vest—handed him a copy of a pamphlet titled *A Jew’s Life in Modern Germany*.

“Would you mind if we take a picture in front of the flag?” he asked my friend after processing his passport application.

My friend stared at the German flag. “What’s this for?” he asked. “Our Web site,” said the German official, then added that the German government hoped to post the photo with a sign that read: THIS MAN IS THE DESCENDANT OF HOLOCAUST SURVIVORS AND HE HAS DECIDED TO RETURN TO GERMANY.

### Deutschland Unter Alles

**C**ommerzbank was the first private bank that the German government had to rescue during the financial crisis, with an injection of \$25 billion, but that’s not why it had caught my attention. I’d been walking around Frankfurt one night with a German financier when I noticed the Commerzbank

## “WHY SHOULD YOU PAY \$20 MILLION TO A 32-YEAR-OLD TRADER? IF I TAKE THE BUSINESS CARD AWAY... HE WOULD PROBABLY SELL HOT DOGS.”

the French. And it wasn’t true. “There had never been any innovation in German banking,” says Enderlein. “You gave money to some company, and the company paid you back. They went [virtually overnight] from this to being American. And they weren’t any good at it.”

What Germans did with money between 2003 and 2008 would never have been possible within Germany, as there was no one to take the other side of the many deals they did which made no sense. They lost massive sums, in everything they touched. Indeed, one view of the European debt crisis—the Greek street view—is that it is an elaborate attempt by the German government on behalf of its banks to get their money back without calling attention to what they are up to. The German government gives money to the European Union rescue fund so that it can give money to the Irish government so that the Irish government can give money to Irish banks so the Irish banks can repay their loans to

Hardly anyone still alive is responsible for what happened: now everyone is. But when everyone is guilty, no one is.

At any rate, if some Martian landed on the streets of Berlin knowing nothing of its history, he might wonder: who are these people called “the Jews” and how did they come to run this place? But there are no Jews in Germany, or not many. “They never see Jews,” says Gary Smith, the director of the American Academy of Berlin. “Jews are unreal to them. When they think of Jews they think of victims.” The farther away the German people get from their victims, the more conspicuously they commemorate them. Of course, no German in his right mind actually wants to sit around remembering the terrible crimes committed by his ancestors—and there are signs, including the memorials, that they are finding ways to move on. A good friend of mine, a Jew whose family was driven out of Germany in the 1930s, recently visited a German consulate to apply for a passport.

building on the skyline. There are strict limits on building heights in Germany, but Frankfurt allows exceptions. The Commerzbank Tower is 53 stories high and unusually shaped: it looks like a giant throne. The top of the building, the arms of the throne, looks more decorative than useful. The interesting thing, said a friend, who visited often, was a room at the top, peering down over Frankfurt. It was a men’s bathroom. Commerzbank executives had taken him up to the top to show him how, in full view of the world below, he could urinate on Deutsche Bank. And if he sat in the stall with the door open...

**@vf.com**  
Q&A: MICHAEL LEWIS ON GREECE, GERMANY, AND WHAT’S TO COME.

The bank’s chairman, Klaus-Peter Müller, actually works in Berlin inside another very German kind of place. His office is attached to the side of the Brandenburg Gate. The Berlin Wall once ran, roughly speaking, right through

the middle of it. One side of his building was once a field of fire for East German border guards, the other a backdrop for Ronald Reagan's famous speech. ("Mr. Gorbachev, open this gate! Mr. Gorbachev, tear down this wall!") Looking at it you would never guess any of this. "After the wall

came down we were offered the chance to buy [this building] back," says Müller. "It had been ours before the war. But the condition was that we had to put everything back *exactly* the way it was. It all had to be *hand-fabricated*." He points out the seemingly antique brass doorknobs and the seemingly

antique windows. "Do not ask me what it cost," the bank chairman says, and laughs. Across Germany, in the past 20 years or so, town centers completely destroyed by bombs in World War II have been restored, stone by stone. If the trend continues, Germany will one day CONTINUED ON PAGE 355

| Spotlight |

STYLED BY DEBORAH AFSHANI; HAIR PRODUCTS BY BUMBIE AND BUMBIE; MAKEUP PRODUCTS BY MAC; GROOMING PRODUCTS BY RENE FURTERER; HAIR BY JAMES PECIS; MAKEUP BY REBECCA RESTREPO; GROOMING BY BIRGITTE PHILIPPDES; SET DESIGN BY WADE & STRAUSS; PRODUCED ON LOCATION AT THE LENOX LOUNGE'S ZEBRA ROOM, N.Y.C.; BY MAURIA KIERNAN; FOR DETAILS, GO TO VF.COM/CREDITS



The creative team behind the new *Porgy and Bess*, from left: David Alan Grier, who plays Sportin' Life; composer Diedre Murray; Audra McDonald, who plays Bess; Norm Lewis, who plays Porgy; director Diane Paulus; playwright Suzan-Lori Parks; and choreographer Ronald K. Brown.

## RETURN TO CATFISH ROW

With its unforgettable music, controversial racial stereotypes, four-hour running time, enormous chorus, and huge orchestra, *Porgy and Bess* has been a problematic classic ever since its debut, in 1935—difficult to stage and equally challenging to interpret.

"It's an American masterpiece, but it hasn't found its voice as a musical with the dramatic values a modern audience expects," says Diane Paulus, artistic director of the American Repertory Theater, who was asked by the trusts of George Gershwin, who wrote the music, and DuBose Heyward, who wrote the book, to "reimagine" *Porgy and Bess* for our time.

Starring Audra McDonald and Norm Lewis, the new production will open the A.R.T.'s 2011–12 season with a six-week run that begins

in Cambridge, Massachusetts, on August 17. This version contains additional material written by Suzan-Lori Parks, the African-American playwright chosen to address the need for textual changes.

"The artist's job is not to be politically correct; the artist's job is to fully realize the characters," says Parks. "They needed to be fleshed out."

Gershwin—who stipulated that the work always be performed by an all-black cast—called *Porgy and Bess* an "American folk opera," and Paulus, who is directing the A.R.T. production, hopes it will capture the contemporary imagination. "What I want is for people to come to it and say, 'I always knew the music was great, but what a story!'" she explains. "What's at the core of this is a heartbreaking love story between two people who find each other, against all odds, and give each other the courage to go on. It's about the power of love to transform." —LESLIE BENNETTS

GRIER WEARS A SUIT BY CANALI, SHIRT BY THOMAS PINK, SHOES BY RALPH LAUREN, SOCKS BY FALKE; WALKING STICK BY TOM FORD. McDONALD WEARS A DRESS BY OSCAR DE LA RENTA; SHOES BY BOTTEGA VENETA. LEWIS WEARS A VEST AND PANTS BY PERRY ELLIS; BOOTS BY FRYE; SCARF BY TOM FORD. PAULUS WEARS A DRESS BY MAX MARA. PARKS WEARS A GOWN BY DONNA KARAN. BROWN WEARS A SUIT, SHIRT, AND TIE BY TOM FORD.

in love with Jennifer. They first met when she took her father to see him on Broadway in *The Capeman* on Father's Day, 1998. "I had never met her," he says. "I'd heard she was a fan of mine, and she walked into my dressing room and I said the worst opening line ever. I don't know what the hell came over me, but I said, 'You're my wife and you don't even know it.' And she said, 'Excuse me?' And I'm like, 'I'm so sorry, I don't know where the fuck that came from.'" He says that he felt their relationship was destined, but I ask, what specifically has she brought to his life? "Beating the shit out of me all the time," he laughs. "No, seriously, she's taught me discipline." Was he flaky? "No. . . . I was just a musician's musician, you know what I mean? And now I get up at six in the morning, film *Hawthorne*, score the show, and I make my meetings." Does he feel that Jennifer works too hard? "She could enjoy life a little more," he admits. "I mean, there are only a certain amount of hours in every day." But, he says, "we know each other, we know when we can't tolerate each other, and we each have that sounding board [in each other]. She's harsh with her criticism sometimes, but it's just because she wants me to be the best I can be. I will always be there for her. It's a very, very dynamic life. I'm taxing myself and pushing myself to the limit, work-wise. But I've been faced with the phone not ringing, and that's not fun. I'd rather this."

**July 9, 2011:** For some, the first public sign of recent trouble was when Jennifer appeared without Marc at the BAFTA "Brits to Watch" gala at the Belasco Theater, in Los Angeles. She wore a green cut-out Pucci gown and took her mother with her to meet Prince William and Kate, the Duchess of Cambridge. But a few days earlier Jennifer had sent me an e-mail that clearly con-

tained a message. She was following up on a few things I had asked her to clarify. What, exactly, had prompted those "revelations" that in order to love properly she had to love herself first? "I'm a hopeless romantic and passionate person when it comes to love," she wrote. "[And] it's not that I didn't love myself before. Sometimes we don't realize that we are compromising ourselves. To understand that a person is not good for you, or that that person is not treating you in the right way, or that he is not doing the right thing for himself—if I stay, then I am not doing the right thing for me. I love myself enough to walk away from that now."

"As women," she continued, "we are naturally giving and we take care of others. I love that part of us and I love doing it. We just have this tendency to put ourselves on the back burner. But we need to be conscious about loving and taking care of ourselves too. . . . The babies had something to do with this. Because when you feel that love for the first time, it's so selfless and pure that it makes you question . . . all the ways you acted and were treated. . . . I'm on a journey to discovering me. So I can teach my babies to do the same thing. So they are always O.K., with or without someone."

**July 20, 2011:** I reach Jennifer in Atlanta, where she is filming *What to Expect When You're Expecting*. Since the July 15 statement, she has made no public comment about the end of her marriage. I ask her: What happened? "This was the hardest decision I've ever had to face," she says. "I really wanted this family to work. That was my biggest dream, and I worked hard at it. We both did. Sometimes it doesn't work—and that's sad. But I remain an eternal optimist about love. I believe in love, as I told you. It's still my biggest dream. I am positive—determined to

move forward with my life, bring up my babies, and do the best job I can as a mother, entertainer, and person. I now look forward to new challenges. I feel strong.

"I spoke to you about wanting to teach Max and Emme certain things," she continues. "For the first time in my life, I can truly say I am loving myself, I am doing loving things for myself. As devastating and heartbreaking as this all has been, this was an important journey for me—necessary and life-changing. Because you can't teach something you don't know completely."

As for her feelings about Marc, she tells me, "I will always respect Marc as a singer and performer. We actually work great together, and he was always *very* supportive. Together we could make magic—and we did. He will always be in our lives. He will always hold a special place in my heart as the father of my children. And out of respect for our family, I will keep private the details of our personal life."

When we first spoke, I had asked Jennifer why there was a question mark on the title of her new album, *Love*? "I don't claim to have the answers," she told me. "I just want to put the questions out there." On that album, there is a song called "Starting Over." It appears that once again, when it comes to love, Jennifer Lopez is starting over. □

## FROM THE ARCHIVE

For these related stories, visit [VE.COM/ARCHIVE](http://VE.COM/ARCHIVE)

- Jennifer Lopez enters *V.F.*'s Hall of Fame (December 1999)
- Living "La Vida Lopez" (Eugenia Peretz, June 2000)
- The "first Latina superstar"—and a *V.F.* cover girl (Ned Zeman, June 2001)
- Jennifer Lopez and friends grace the Music Issue (November 2002)

## Europe's Financial Crisis



CONTINUED FROM PAGE 311 appear as if nothing terrible ever happened in it, when *everything* terrible happened in it.

He then offers me the same survey of German banking that I will hear from half a dozen others. German banks are not, like American

banks, mainly private enterprises. Most are either explicitly state-backed "lands banks" or small savings co-ops. Commerzbank, Dresdner Bank, and Deutsche Bank, all founded in the 1870s, were the only three big private German banks. In 2008, Commerzbank bought Dresdner; as both turned out to be loaded with toxic assets, the merged bank needed to be rescued by the German government. "We are not a prop-trading nation," he says, getting to the nub of where German banks went so wildly wrong. "Why should you pay \$20 million to a 32-year-old trader? He uses the office space, the I.T., the business card with a first-class name on it. If I take the business card away from that guy he would probably sell hot dogs." He is the German equivalent of the head of Bank of America, or Citigroup, and he is actively hostile to the idea that bankers should make huge sums of money.

In the bargain, he tells me why the current financial crisis has left so unsettled the German banker's view of the financial universe. In the early 1970s, after he started at Commerzbank, the bank opened the first New York branch of any German bank, and he went to work in it. He mists up a bit when he tells stories about the Americans he did business with back then: in one story an American investment banker who had inadvertently shut him out of a deal hunts him down and hands him an envelope with 75 grand in it, because he hadn't meant for the German bank to get stiffed. "You have to understand," he says emphatically, "this is where I get my view of Americans." In the past few years, he adds, that view has changed.

"How much did you lose?" I ask.

"I don't want to tell you," he says.

He laughs and then continues. "For 40

# Europe's Financial Crisis

years we didn't lose a penny on anything with a triple-A rating," he says. "We stopped building the portfolio in subprime in 2006. I had the idea that there was something wrong with your market." He pauses. "I was in the belief that the best supervised of all banking systems was in New York. To me the Fed and the S.E.C. were second to none. I did not believe that there would be e-mail traffic between investment bankers saying that they were selling . . ." He pauses and decides he shouldn't say "shit." "Dirt," he says instead. "This is by far my biggest professional disappointment. I was in a much too positive way U.S.-biased. I had a set of beliefs about U.S. values."

The global financial system may exist to bring borrowers and lenders together, but it has become over the past few decades something else too: a tool for maximizing the number of encounters between the strong and the weak, so that one might exploit the other. Extremely smart traders inside Wall Street investment banks devise deeply unfair, diabolically complicated bets, and then send their sales forces out to scour the world for some idiot who will take the other side of those bets. During the boom years a wildly disproportionate number of those idiots were in Germany. As a reporter for Bloomberg News in Frankfurt, named Aaron Kirchfeld, put it to me, "You'd talk to a New York investment banker, and they'd say, 'No one is going to buy this crap. Oh. Wait. The Landesbanks will!'" When Morgan Stanley designed extremely complicated credit-default swaps all but certain to fail so that their own proprietary traders could bet against them, the main buyers were German. When Goldman Sachs helped the New York hedge-fund manager John Paulson design a bond to bet against—a bond that Paulson hoped would fail—the buyer on the other side was a German bank called IKB. IKB, along with another famous fool at the Wall Street poker table called WestLB, is based in Düsseldorf—which is why, when you asked a smart Wall Street bond trader who was buying all this crap during the boom, he might well say, simply, "Stupid Germans in Düsseldorf."

The drive from Berlin to Düsseldorf takes longer than it should. For long stretches the highway is choked with cars and trucks. A German traffic jam is a peculiar sight: no one honks; no one switches lanes searching for some small, illusory advantage; all trucks remain in the right-hand lane, where they are required to be. The spectacle, sparkling Audis and Mercedeses in the left lane, and immaculate trucks neatly rowed up in the right lane, is almost a pleasure to watch.

Because everyone in it obeys the rules, and believes that everyone else will obey them, too, it moves as fast as it can, given the circumstances. But the pretty young German woman behind the wheel of our car doesn't take any pleasure in it. Charlotte huffs and groans at the sight of brake lights stretching into the distance. "I hate being stuck in traffic," she says apologetically.

She pulls from her bag the German edition of Alan Dundes's book, the title of which translates as *You Lick Mine First*. I ask her about it. There is a common German expression, she explains, which translates directly as "Lick my ass." To this hearty salutation the common reply is "You lick mine first!" "Everyone will understand this title," she says. "But this book, I don't know about this."

The last time I'd been in Germany for more than a few days was when I was 17 years old. I traveled across the country with two friends, a bike, a German phrase book, and a German love song taught to me by an American woman of German descent. So few people spoke English that it was better to deploy whatever German came to hand—which usually meant the love song. And so I assumed on this trip I would need an interpreter. I didn't appreciate how much the Germans had been boning up on their English. The entire population seems to have taken a total-immersion Berlitz course in the last few decades. And on Planet Money, even in Germany, English is the official language. It's the working language used for all meetings inside the European Central Bank, even though the E.C.B. is in Germany and the only E.C.B. country in which English is arguably the native tongue is Ireland.

At any rate, through a friend of a friend of a friend I'd landed Charlotte, a sweet-natured, keenly intelligent woman in her 20s who was also shockingly steely—how many sweet-natured young women can say "Lick my ass" without blushing? She spoke seven languages, including Chinese and Polish, and was finishing up her master's degree in Intercultural Misunderstanding, which just has to be Europe's next growth industry. By the time I realized I didn't need an interpreter, I'd already hired her. So she became my driver. As my interpreter, she would have been ridiculously overqualified; as my chauffeur, she is frankly preposterous. But she'd taken on the job with gusto, going so far as to hunt down the old German translation of Dundes's little book.

And it troubled her. For a start she refused to believe there was such a thing as a German national character. "No one in my field believes this anymore," she says. "How do you generalize about 80 million people? You can say they are all the same, but why would they be this way? My question about

Germans' being anally obsessed is how would this spread? Where would it come from?" Dundes himself actually made a stab at answering that question. He suggested that the unusual swaddling techniques employed by German mothers, which left German babies stewing in their own filth for long periods, might be partly responsible for their energetic anality. Charlotte was not buying it. "I've never heard of this," she says.

But just then she spots something and brightens. "Look!" she says. "A German flag." Sure enough, a flag flies over a small house in a distant village. You can spend days in Germany without seeing a flag. Germans aren't allowed to cheer for their team in the way other peoples are. That doesn't mean they don't want to, just that they must disguise what they are doing. "Patriotism," she says, "is still taboo. It's politically incorrect to say, 'I'm proud to be German.'"

The traffic now eases, and we're once again flying toward Düsseldorf. The highway looks brand new, and she guns the rented car until the speedometer tops 210.

"This is a really good road," I say.

"The Nazis built it," she says. "That's what people say about Hitler, when they get tired of saying the usual things. 'Well, at least he built good roads.'"

Back in February 2004 a financial writer in London named Nicholas Dunbar broke the story about some Germans in Düsseldorf, working inside a bank called IKB, who were up to something new. "The name 'IKB' just kept coming up in London with bond salesmen," says Dunbar. "It was like everybody's secret cash cow." Inside the big Wall Street firms there were people whose job it was, when the German customers from Düsseldorf came to London, to have a wad of cash and make sure they got whatever they wanted.

Dunbar's piece appeared in *Risk* magazine and described how this obscure German bank was rapidly turning into Wall Street's biggest customer. IKB had been created back in 1924 to securitize German war-reparation payments to the Allies, morphed into a successful lender to midsize German companies, and was now morphing into something else. The bank was partially owned by a German state bank, but was not itself guaranteed by the German government. It was a private German financial enterprise, seemingly on the rise. And it had recently hired a man named Dirk Röthig, a German with some experience in the United States (he'd worked for State Street Bank), to do something new and interesting.

With Röthig's help IKB created, in effect, a bank, called Rhineland Funding, incorporated in Delaware and listed on the exchange in Dublin, Ireland. They didn't call it a bank. Had they done so, people might

have asked why it was not regulated. They called it a “conduit,” a word that had the advantage that hardly anyone understood what it meant. Rhineland borrowed money for short periods of time by issuing what is called commercial paper. It invested that money in longer-term “structured credit,” which turned out to be a euphemism for bonds backed by consumer loans. Some of the same Wall Street investment banks that raised the money for Rhineland (by selling the commercial paper) sold Rhineland, among other things, U.S. subprime bonds. Rhineland’s profits came from the difference between the rate of interest it paid on the money borrowed and the higher rate of interest it earned on the money it lent through its bond purchases. As IKB guaranteed the entire enterprise, Moody’s gave Rhineland its highest rating, enabling it to borrow money cheaply.

The Germans in Düsseldorf had one critical job: to advise this offshore bank they had created on which bonds it should buy. “We are one of the last to get money out of Rhineland,” Röthig told *Risk* magazine, “but we’re so confident in our ability to advise it in the right way that we still make a profit.” Röthig further explained that IKB had invested in special tools to analyze these complicated bonds, called collateralized debt obligations (C.D.O.’s), that Wall Street was now peddling. “I would say it has proven a worthwhile investment because we have not faced a loss so far,” he said. In February 2004 all this seemed like a good idea—so good that lots of other German banks rented IKB’s conduit and bought subprime-mortgage bonds for themselves. “It sounds like quite a profitable strategy,” the man from Moody’s who had awarded Rhineland’s commercial paper its top rating told *Risk*.

I met Dirk Röthig for lunch at a restaurant in Düsseldorf, on a canal lined with busy shops. From their profitable strategy the German banks have declared losses of something like \$50 billion, though their actual losses are probably greater, as German banks are so slow to declare anything. Röthig viewed himself, with some justice, more as victim than perpetrator. “I left the bank in December 2005,” he says quickly as he squeezes himself into a small booth. Then he explains.

The idea for the offshore bank had been his. The German management at IKB had taken to it, as he put it, “as a baby takes to candy.” He’d created the bank when the market was paying higher returns to bondholders: Rhineland Funding was paid well for the risk it was taking. By the middle of 2005, with the financial markets refusing to see a cloud in the sky, the price of risk had collapsed. Röthig says he went to his superiors and argued that IKB should look

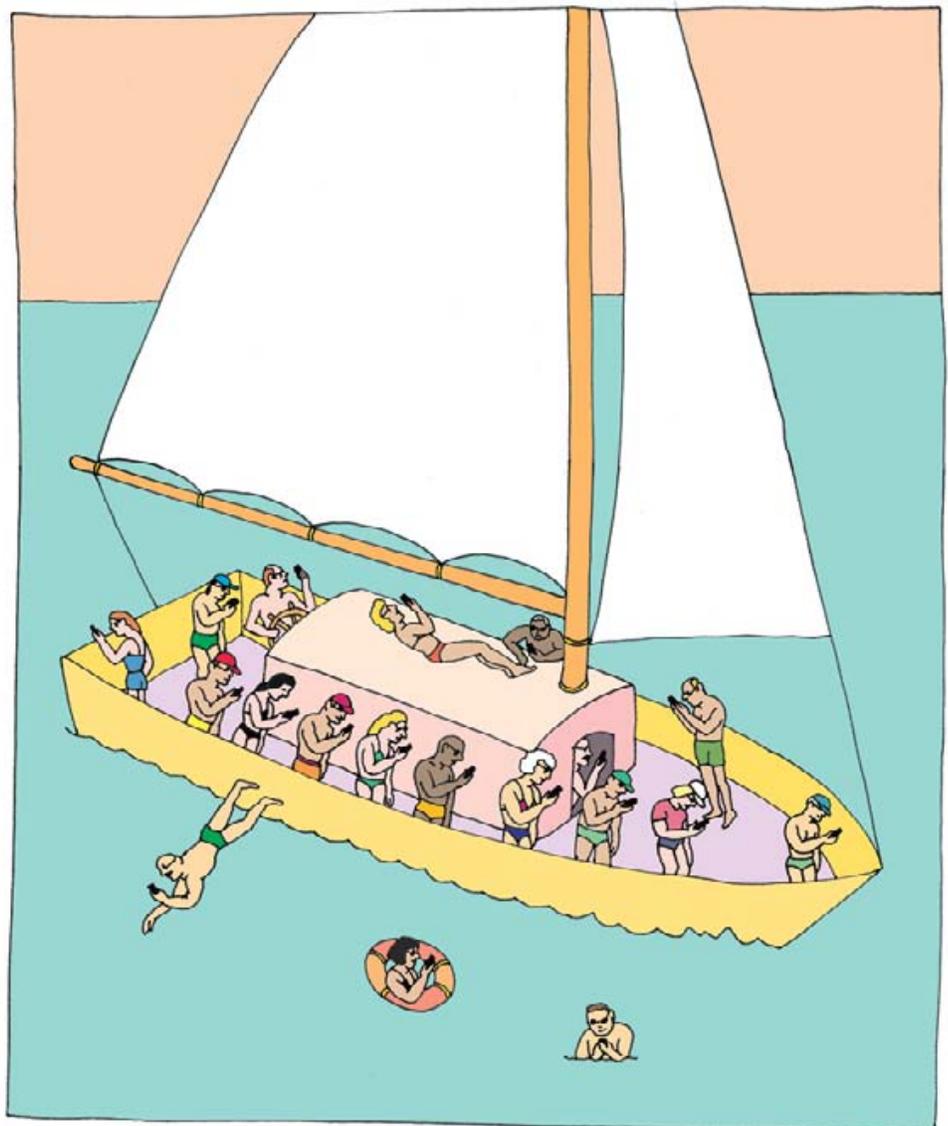
elsewhere for profits. “But they had a profit target and they wanted to meet it. To make the same profit with a lower risk spread they simply had to buy more,” he says. The management, he adds, did not want to hear his message. “I showed them the market was turning,” he says. “I was taking the candy away from the baby, instead of giving it. So I became the enemy.” When he left, others left with him, and the investment staff was reduced, but the investment activity boomed. “One-half the number of people with one-third the experience made twice the number of investments,” he says. “They were ordered to buy.”

He goes on to describe what appeared to be a scrupulous and complicated investment strategy but was actually a mindless, rule-based investment strategy. IKB could “price a C.D.O. to the last basis point,” as one admiring observer told *Risk*

in 2004. But this expertise was a kind of madness. “They would be really anal about, say, which subprime originator went into these C.D.O.’s,” says Nicholas Dunbar. “But it didn’t matter. They were arguing about bonds that would collapse from 100 down to 2 or 3. In a sense they were right: they bought the bonds that went to 3, rather than to 2.” As long as the bonds offered up by the Wall Street firms abided by the rules specified by IKB’s experts, they got hoovered into the Rhineland Funding portfolio without further inspection. Yet the bonds were becoming radically more risky because the loans that underpinned them were becoming crazier and crazier.

After he left, the IKB portfolio went from \$10 billion in 2005 to \$20 billion in 2007, Röthig says, and “it would have gotten bigger if they had had more time to buy. They were still buying when the market crashed. They were on their way to \$30 billion.” By

SKETCHBOOK: BY SEYMOUR CHWAST



# Europe's Financial Crisis

the middle of 2007 every Wall Street firm, not just Goldman Sachs, realized that the subprime market was collapsing, and tried frantically to get out of their positions. The last buyers in *the entire world*, several people on Wall Street have told me, were these willfully oblivious Germans. That is, the only thing that stopped IKB from losing even more than \$15 billion on U.S. subprime loans was that the market ceased to function. Nothing that happened—no fact, no piece of data—was going to alter their approach to investing money.

On the surface IKB's German bond traders resembled the reckless traders who made similarly stupid bets for Citigroup and Morgan Stanley. Beneath it they were playing an entirely different game. The American bond traders may have sunk their firms by turning a blind eye to the risks in the subprime-bond market, but they made a fortune for themselves in the bargain and have for the most part never been called to account. They were paid to put their firms in jeopardy, and so it is hard to know whether they did it intentionally or not. The German bond traders, on the other hand, had been paid roughly \$100,000 a year, with, at most, another \$50,000 bonus. In general, German bankers were paid peanuts to run the risk that sank their banks—which suggests they really didn't know what they were doing. But—and here is the strange thing—unlike their American counterparts, they are being treated by the German public as crooks. The former C.E.O. of IKB, Stefan Ortseifen, received a 10-month suspended sentence and has been asked by the bank to return his salary: eight hundred and five thousand euros.

The border created by modern finance between Anglo-American and German bankers was treacherous. "The intercultural misunderstandings were quite intense," Röthig says as he tucks into his lobster. "The people in these banks had never been spoiled by any Wall Street salesman. Suddenly, there is someone with a platinum American Express credit card who can take them to the Grand Prix in Monaco, takes them to all these places. He has no limit. The Landesbanks were the most boring bankers in Germany, so they never got attention like this. And all of a sudden a very smart guy from Merrill Lynch shows up and starts to pay a lot of attention to you. They thought, Oh, he just likes me!" He completes the thought. "The American salespeople are much smarter than the European ones. They play a role much better."

At bottom, he says, the Germans were blind to the possibility that the Americans

were playing the game by something other than the official rules. The Germans took the rules at their face value: they looked into the history of triple-A-rated bonds and accepted the official story that triple-A-rated bonds were completely risk-free.

This preternatural love of rules, almost for their own sake, punctuates German finance as it does German life. As it happens, a story had just broken that a division of a German insurance company called Munich Re, back in June 2007, or just before the crash, had sponsored a party for its best producers that offered not just chicken dinners and nearest-to-the-pin golf competitions but a blowout with prostitutes in a public bath. In finance, high or low, this sort of thing is of course not unusual. What was striking was how organized the German event was. The company tied white and yellow and red armbands to the prostitutes to indicate which ones were available to which men. After each sexual encounter the prostitute received a stamp on her arm, to indicate how often she had been used. The Germans didn't want just hookers: they wanted hookers with *rules*.

Perhaps because they were so enamored of the official rules of finance, the Germans proved especially vulnerable to a false idea the rules encouraged: that there is such a thing as a riskless asset. There is no such thing as a riskless asset. The reason an asset pays a return is that it carries risk. But the idea of the riskless asset, which peaked in late 2006, overran the investment world, and the Germans fell for it the hardest. I'd heard about this, too, from people on Wall Street who had dealt with German bond buyers. "You have to go back to the German mentality," one of them had told me. "They say, 'I've ticked all the boxes. There is no risk.' It was form over substance. You work with Germans, and—I can't emphasize this enough—they are not natural risk-takers." So long as a bond looked clean on the outside, the Germans allowed it to become as dirty on the inside as Wall Street could make it.

The point Röthig wants to stress to me now is that *it didn't matter* what was on the inside. IKB had to be rescued by a state-owned bank on July 30, 2007. Against capital of roughly \$4 billion it had lost more than \$15 billion. As it collapsed, the German media wanted to know how many U.S. subprime bonds these German bankers had gobbled up. IKB's C.E.O., Stefan Ortseifen, said publicly that IKB owned almost no subprime bonds at all—which is why he's recently been convicted of misleading investors. "He was telling the truth," says Röthig. "He didn't think he owned any subprime. They weren't able to give any correct numbers of the amount of subprime they had

because they didn't know. The IKB monitoring systems did not make a distinction between subprime and prime mortgages. And that's why it happened." Back in 2005, Röthig says, he had proposed building a system to track more precisely what loans were behind the complex bonds they were buying from Wall Street firms, but IKB's management didn't want to spend the money. "I told them, You have a portfolio of \$20 billion, you are making \$200 million a year, and you are denying me \$6.5 million. But they didn't want to do it."

## As Clear as Mud

For the third time in as many days we cross the border without being able to see it, and spend 20 minutes trying to work out if we are in East or West Germany. Charlotte was born and raised in the East German city of Leipzig, but she is no less uncertain than I am about which former country we are in. "You just would not know anymore unless you are told," she says. "They have to put up a sign to mark it." A landscape once scarred by trenches and barbed wire and minefields exhibits not so much as a ripple. Somewhere near this former border we pull off the road into a gas station. It has three pumps in a narrow channel without space to maneuver or to pass. The three drivers filling their gas tanks need to do it together, and move along together, for if any one driver dawdles, everyone else must wait. No driver dawdles. The German drivers service their cars with the efficiency of a pit crew. Precisely because the arrangement is so archaic Charlotte guesses we must still be in West Germany. "You would never find this kind of gas station in East Germany," she says. "Everything in East Germany is new."

She claims she can guess at sight whether a person, and especially a man, is from the East or the West. "West Germans are much prouder. They stand straight. East Germans are more likely to slouch. West Germans think East Germans are lazy."

"East Germans are the Greeks of Germany," I say.

"Be careful," she says.

From Düsseldorf we drive to Leipzig, and from Leipzig we hop on a train to Hamburg, to find the mud-wrestling. Along the way she searches for signs of anality in her native tongue. "*Kackwurst* is the term for feces," she says grudgingly. "It literally means 'shit sausage.' And it's horrible. When I see sausages I can't think of anything else." She thinks a moment. *Bescheissen*: "Someone shit on you." *Klugscheisser*: "an intelligence shitter." "If you have a lot of money," she says, "you are said to shit money: *Geldscheisser*." She rips off a handful of other examples, off the top of her head, a little shocked by how fertile this line of thinking is, before she says, "And if you find yourself

in a bad situation you say, *Die Kacke ist am Dampfen*: the shit is steaming.”

She stops and appears to realize she is encouraging a theory of German character.

“It’s just in the words,” she says. “It doesn’t mean it applies.”

Outside of Hamburg we stopped for lunch at a farm, owned by a man named Wilhelm Nölling, a German economist now in his 70s. Back when the idea of the euro was being bandied about, he’d been a council member of the Bundesbank. From the moment the discussion turned serious, Nölling has railed against the euro. He wrote a mournful pamphlet, *Goodbye to the Deutsche Mark?* He wrote another, more declarative pamphlet, *The Euro: A Journey to Hell*. Together with three other prominent German economists and financial leaders, he filed a lawsuit, still wending its way through the German courts, challenging the euro on constitutional grounds. Just before the deutsche mark got scrapped, Nölling had argued to the Bundesbank that they should just keep all the notes. “I said, ‘Don’t shred it!’” he now says with great gusto, leaping out of an armchair in the living room of his farmhouse. “I said, ‘Pile it all up, put it in a room, in case we need it later!’”

He finds himself stuck: he knows he is tilting at windmills. “Can you turn this back?” he says. “We know we can’t turn this back. If they say, ‘O.K., we were wrong. You were right,’ what do you do? That is the hundred-thousand-million-dollar question.” He thinks he knows what should be done, but doesn’t think Germans are capable of doing it. The idea he and his fellow dissident German economists have cooked up is to split the European Union in two, for financial purposes. One euro, a kind of second-string currency, would be issued for, and used by, the deadbeat countries—Greece, Portugal, Spain, Italy, and so on. The first-string euro would be used by “the homogenous countries, the ones you can rely on.” He lists these reliable countries: Germany, Austria, Belgium, the Netherlands, Finland, and (he hesitates for a second over this) France.

“Are you sure the French belong?”

“We discussed this,” he says seriously. They decided that for social reasons you

couldn’t really exclude the French. It was just too awkward.

As he presided over the Maastricht treaty, that created the euro, the French president François Mitterrand is rumored to have said, privately, that yoking Germany to the rest of Europe in this way was sure to lead to imbalances, and the imbalances were certain to lead to some crisis, but by the time the crisis struck he’d be dead and gone—and others would sort it out. Even if Mitterrand didn’t say exactly that, it’s the sort of thing he should have said, as he surely thought it. At the time, it was obvious to a lot of people that these countries did not belong together.

But then, how did people who seem so intelligent and successful and honest and well organized as the Germans allow themselves to be drawn into such a mess? In their financial affairs they’d ticked all the little boxes to ensure that the contents of the bigger box were not rotten, and yet ignored the overpowering stench wafting from the big box. Nölling felt the problem had its roots in the German national character. “We entered Maastricht because they had these *rules*,” he says as we move off to his kitchen and plates heaped with the white asparagus Germans take such pride in growing. “We were talked into this under false pretenses. Germans are by and large glib people. They trust and believe. They *like* to trust. They *like* to believe.”

If the deputy finance minister has a sign on his wall reminding him to see the point of view of others, here is perhaps why. Others do not behave as Germans do: others *lie*. In this financial world of deceit, Germans are natives on a protected island who have not been inoculated against the virus carried by visitors. The same instincts that allowed them to trust the Wall Street bond salesman also allowed them to trust the French when they promised there would be no bailouts, and the Greeks when they swore that their budget was balanced. That is one theory. Another is that they trusted so easily because they didn’t care enough about the cost of being wrong, as it came with certain benefits. For the Germans the euro isn’t just a currency. It’s a device for flushing the past—another Holocaust Memorial. The German public-opinion polls are now running against the

Greeks, but deeper forces run in their favor.

In any case, if you are obsessed with cleanliness and order yet harbor a secret fascination with filth and chaos, you are bound to get into some kind of trouble. There is no such thing as clean without dirt. There is no such thing as purity without impurity. The interest in one implies an interest in the other.

The young German woman who had driven me back and forth across Germany exhibits interest in neither, and it’s hard to say whether she is an exception or a new rule. Still, she marches dutifully into Europe’s largest red-light district, seeking out a lot of seedy-looking German men to ask them where she might find a female mud-wrestling show. She continues to discover new and surprising ways in which Germans find meaning in filth. “*Scheisse glänzt nicht, wenn man sie poliert*—Shit won’t shine, even if you polish it,” she says as we pass the Funky Pussy Club. “*Scheissegal*: it just means I don’t give a shit.” She laughs. “That’s an oxymoron in Germany, right?”

The night is young and the Reeperbahn is hopping: it’s the closest thing I’ve seen in Germany to a mob scene. Hawkers lean against sex clubs and parse likely customers from the passing crowds. Women who are almost pretty beckon men who are clearly tempted. We pass several times the same corporate logo, a pair of stick figures engaged in anal sex. Charlotte spots it and remembers that a German band, Rammstein, was arrested in the United States for simulating anal sex onstage, while performing a song called “Bück Dich” (“Bend Over”). But on she charges, asking old German men where to find the dirt. At length she finds a definitive answer, from a German who has worked here for decades. “The last one shut down years ago,” he says. “It was too expensive.” □

## FROM THE ARCHIVE

For these related stories, visit [VE.COM/ARCHIVE](http://VE.COM/ARCHIVE)

- Euro disasterland, Part I: Iceland (Michael Lewis, April 2009)
- Euro disasterland, Part II: Greece (Michael Lewis, October 2010)
- Euro disasterland, Part III: Ireland (Michael Lewis, March 2011)

VANITY FAIR IS A REGISTERED TRADEMARK OF ADVANCE MAGAZINE PUBLISHERS INC. COPYRIGHT © 2011 CONDÉ NAST. ALL RIGHTS RESERVED. PRINTED IN THE U.S.A.

VOLUME 53, NO. 9, VANITY FAIR (ISSN 0733-8899) is published monthly by Condé Nast, which is a division of Advance Magazine Publishers Inc.

PRINCIPAL OFFICE: The Condé Nast Building, 4 Times Square, New York, NY 10036. S. I. Newhouse, Jr., Chairman; Charles H. Townsend, Chief Executive Officer; Robert A. Sauerberg, Jr., President; John W. Bellando, Chief Operating Officer & Chief Financial Officer; Jill Bright, Chief Administrative Officer. Periodicals postage paid at New York, NY, and at additional mailing offices. Canada Post Publications Mail Agreement No. 40644503. Canadian Goods and Services Tax Registration No. 123242885-RT0001. Canada Post: return undeliverable Canadian addresses to P.O. Box 874, Station Main, Markham, ON L3P 8L4. POSTMASTER: SEND ADDRESS CHANGES TO VANITY FAIR, P.O. Box 37714, Boone, IA 50037-0714. FOR SUBSCRIPTIONS, ADDRESS CHANGES, ADJUSTMENTS, OR BACK ISSUE INQUIRIES: Please write to VANITY FAIR, P.O. Box 37714, Boone, IA 50037-0714, call 800-365-0635, or e-mail [subscriptions@vf.com](mailto:subscriptions@vf.com). Please give both new and old addresses as printed on most recent label. Subscribers: If the Post Office alerts you that your magazine is undeliverable, we have no further obligation unless we receive a corrected address within one year. If during your subscription term or up to one year after the magazine becomes undeliverable, you are ever dissatisfied with your subscription, let us know. You will receive a full refund on all unmailed issues. First copy of new subscription will be mailed within eight weeks after receipt of order. Send all editorial, business, and production correspondence electronically to [vfmail@vf.com](mailto:vfmail@vf.com). For permissions requests, please call 212-630-5656 or fax the request to 212-630-5883. For reprints of articles, please contact Scoop ReprintSource at 800-767-3263 or via e-mail at [sales@scoopreprintsources.com](mailto:sales@scoopreprintsources.com). Visit us online at [www.vf.com](http://www.vf.com). To subscribe to other Condé Nast magazines on the World Wide Web, visit [www.condenastdigital.com](http://www.condenastdigital.com). Occasionally, we make our subscriber list available to carefully screened companies that offer products and services that we believe would interest our readers. If you do not want to receive these offers and/or information, please advise us at P.O. Box 37714, Boone, IA 50037-0714 or call 800-365-0635.

VANITY FAIR IS NOT RESPONSIBLE FOR THE RETURN OR LOSS OF, OR FOR DAMAGE OR ANY OTHER INJURY TO, UNSOLICITED MANUSCRIPTS, UNSOLICITED ART WORK (INCLUDING, BUT NOT LIMITED TO, DRAWINGS, PHOTOGRAPHS, AND TRANSPARENCIES), OR ANY OTHER UNSOLICITED MATERIALS. THOSE SUBMITTING MANUSCRIPTS, PHOTOGRAPHS, ART WORK, OR OTHER MATERIALS FOR CONSIDERATION SHOULD NOT SEND ORIGINALS, UNLESS SPECIFICALLY REQUESTED TO DO SO BY VANITY FAIR IN WRITING. MANUSCRIPTS, PHOTOGRAPHS, AND OTHER MATERIALS SUBMITTED MUST BE ACCOMPANIED BY A SELF-ADDRESSED STAMPED ENVELOPE.

**ECONOMIC CYCLE**

Former California governor Arnold Schwarzenegger in Santa Monica. To earn money when he first came to America, in 1968, he built brick walls nearby with fellow bodybuilder Franco Columbu.



# California

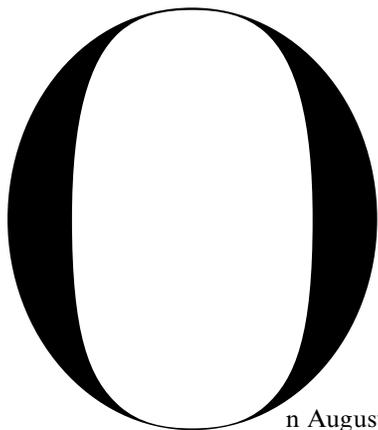
The smart money says the U.S. economy will splinter, with some states thriving, some states not, and all eyes are on California as the nightmare scenario. After a hair-raising visit with former governor Arnold Schwarzenegger, who explains why the Golden State has cratered, MICHAEL LEWIS goes where the buck literally stops—the local level, where the likes of San Jose mayor Chuck Reed and Vallejo fire chief Paige Meyer are trying to avert even worse catastrophes and rethink what it means to be a society

---



FOR DETAILS, GO TO VF.COM/CREDITS

# *and* Bust



On August 5, 2011, moments after the U.S. government watched a rating agency lower its credit rating for the first time in American history, the market for U.S. Treasury bonds soared. Four days later, the interest rates paid by the U.S. government on its new 10-year bonds were plummeting on their way to record lows. The price of gold rose right alongside the price of U.S. Treasury bonds, but the prices of virtually all stocks and other bonds in rich Western countries went into a free fall. The net effect of a major U.S. rating agency's saying that the U.S. government was less likely than before to repay its debts was to lower the cost of borrowing for the U.S. government and to raise it for everyone else. This told you a lot of what you needed to know about the ability of the U.S. government to live beyond its means: it had, for the moment, a blank check. The shakier the United States government appeared, up to some faraway point, the more cheaply it would be able to borrow. It wasn't exposed yet to the same vicious

it couldn't be paid, whatever the amount. At the end of the piece, Kroft asked Whitney what she thought about the ability and willingness of the American states to repay their debts. She didn't see a real risk that the states would default, because the states had the ability to push their problems down to counties and cities. But at these lower levels of government, where American life was lived, she thought there would be serious problems. "You could see 50 to a hundred sizable defaults, [maybe] more," she said. A minute later Kroft returned to her to ask when people should start worrying about a crisis in local finances. "It'll be something to worry about within the next 12 months," she said.

That prophecy turned out to be self-fulfilling: people started worrying about U.S. municipal finance the minute the words were out of her mouth. The next day the municipal-bond market tanked. It kept falling right through the next month. It fell so far, and her prediction received so much attention, that money managers who had put clients into municipal bonds felt compelled to hire more people to analyze states and cities, to prove her wrong. (One of them called it "the Meredith Whitney Municipal Bond Analyst Full Employment Act.") Inside the financial world a new literature was born, devoted to persuading readers that Meredith Whitney didn't know what she was talking about. She was vulnerable to the charge: up until the moment she appeared on *60 Minutes* she had, so far as anyone knew, no experience at all of U.S. municipal finance. Many of the articles attacking her accused her of making a very specific forecast—as many as a hundred defaults within a year!—that failed to materialize. (Sam-

## “THERE WERE TIMES OF FRUSTRATION,” SAYS SCHWARZENEGGER. “BUT IF YOU WANT TO LIVE RATHER THAN JUST EXIST, YOU WANT THE DRAMA.”

cycle that threatened the financial life of European countries: a moment of doubt leads to higher borrowing costs, which leads to greater doubt and even higher borrowing costs, and so on until you become Greece. The fear that the United States might actually not pay back the money it had borrowed was still unreal.

On December 14, 2010, the television news program *60 Minutes* aired a 14-minute piece about U.S. state and local finances. Correspondent Steve Kroft interviewed a private Wall Street analyst named Meredith Whitney, who, back in 2007, had gone from being obscure to famous when she correctly suggested that Citigroup's losses in U.S. subprime bonds were far bigger than anyone imagined, and predicted the bank would be forced to cut its dividend. The *60 Minutes* segment noted that U.S. state and local governments faced a collective annual deficit of roughly half a trillion dollars, adding that another trillion-dollar gap existed between what the governments owed retired workers and the money they had on hand to pay them. Whitney pointed out that even these numbers were unreliable, and probably optimistic, as the states did a poor job of providing information about their finances to the public. New Jersey governor Chris Christie concurred with her and added, "At this point, if it's worse, what's the difference?" The bill owed by American states to retired American workers was so large that

ple Bloomberg News headline: MEREDITH WHITNEY LOSES CREDIBILITY AS MUNI DEFAULTS FALL 60%.) The whirlwind thrown up by the brief market panic sucked in everyone who was anywhere near municipal finance. The nonpartisan, dispassionate, sober-minded Center on Budget and Policy Priorities, in Washington, D.C., even released a statement saying that there was a "mistaken impression that drastic and immediate measures are needed to avoid an imminent fiscal meltdown." This was treated in news accounts as a response to Meredith Whitney, as she was the only one in sight who could be accused of having made such a prediction.

But that's not at all what she had said: her words were being misrepresented so that her message might be more easily attacked. "She was referring to the complacency of the ratings agencies and investment advisers who say there is nothing to worry about," said a person at *60 Minutes* who reviewed the transcripts of the interview for me, to make sure I had heard what I thought I had heard. "She says there is something to worry about, and it will be apparent to everyone in the next 12 months."

Whatever else she had done, Meredith Whitney had found the pressure point in American finance: the fear that American cities would not pay back the money they had borrowed. The market for municipal bonds, unlike the market for U.S. government

Mayor Chuck Reed at San Jose City Hall. *Bottom*, interim city manager Phil Batchelor in his office in Vallejo, California. "I think we've suffered from a series of mass delusions," Reed says.



## HAIL TO THE CHIEF

Vallejo fire chief Paige Meyer training new recruits (hired with a grant from FEMA) on Mare Island, California. His department was cut from 121 men to 67 in 2008.



bonds, spooked easily. American cities and states were susceptible to the same cycle of doom that had forced Greece to seek help from the International Monetary Fund. All it took to create doubt and raise borrowing costs for states and cities was for a woman with no standing in the municipal-bond market to utter a few sentences on television. That was the amazing thing: she had offered nothing to back up her statement. She'd written a massive, detailed report on state and local finances, but no one except a handful of her clients had any idea what was in it. "If I was a real nasty hedge-fund guy," one hedge-fund manager put it to me, "I'd sit back and say, 'This is a herd of cattle that can be stampeded.'"

**W**hat Meredith Whitney was trying to say was more interesting than what she was accused of saying. She didn't actually care all that much about the municipal-bond market, or how many cities were likely to go bankrupt. The municipal-bond market was a dreary backwater. As she put it, "Who cares about the stinking muni-bond market?" The only reason she had stumbled into that market was that she had come to view the U.S. national economy as a collection of regional economies. To understand the regional economies, she had to understand how state and local governments were likely to behave, and to understand this she needed to understand their finances. Thus she had spent two unlikely years researching state and local finance. "I didn't have a plan to do this," she said. "Not one of my clients asked for it. I only looked at this because I needed to understand it myself. How it started was with a question: How can G.D.P. [gross domestic product] estimates be so high when

the states that outperformed the U.S. economy during the boom were now underperforming the U.S. economy—and they were 22 percent of that economy?" It was a good question.

From 2002 to 2008, the states had piled up debts right alongside their citizens: their level of indebtedness, as a group, had almost doubled, and state spending had grown by two-thirds. In that time they had also systematically underfunded their pension plans and other future liabilities by a total of nearly \$1.5 trillion. In response, perhaps, the pension money that they had set aside was invested in ever riskier assets. In 1980 only 23 percent of state pension money had been invested in the stock market; by 2008 the number had risen to 60 percent. To top it off, these pension funds were pretty much all assuming they could earn 8 percent on the money they had to invest, at a time when the Federal Reserve was promising to keep interest rates at zero. Toss in underfunded health-care plans, a reduction in federal dollars available to the states, and the depression in tax revenues caused by a soft economy, and you were looking at multi-trillion-dollar holes that could be dealt with in only one of two ways: massive cutbacks in public services or a default—or both. Whitney thought default unlikely, at least at the state level, because the state could bleed the cities of money to pay off its bonds. The cities were where the pain would be felt most intensely. "The scary thing about state treasurers," she said, "is that they don't know the financial situation in their own municipalities."

"How do you know that?"

"Because I asked them!"

All states may have been created equal, but they were equal no longer. The states that had enjoyed the biggest boom were now facing the biggest busts. "How does the United States emerge from the credit crisis?" Whitney asked herself. "I was convinced—because

the credit crisis had been so different from region to region—that it would emerge with new regional strengths and weaknesses. Companies are more likely to flourish in the stronger states; the individuals will go to where the jobs are. Ultimately, the people will follow the companies.” The country, she thought, might organize itself increasingly into zones of financial security and zones of financial crisis. And the more clearly people understood which zones were which, the more friction there would be between the two. (“Indiana is going to be like, ‘N.F.W. I’m bailing out New Jersey.’”) As more and more people grasped which places had serious financial problems and which did not, the problems would only increase. “Those who have money and can move do so,” Whitney wrote in her report to her Wall Street clients, “those without money and who cannot move do not, and ultimately rely more on state and local assistance. It becomes effectively a ‘tragedy of the commons.’”

## “THERE’S A CORRUPTION HERE,” SAYS MAYOR REED. “IT’S NOT JUST A FINANCIAL CORRUPTION. IT’S A CORRUPTION OF THE ATTITUDE OF PUBLIC SERVICE.”

The point of Meredith Whitney’s investigation, in her mind, was not to predict defaults in the municipal-bond market. It was to compare the states with one another so that they might be ranked. She wanted to get a sense of who in America was likely to play the role of the Greeks, and who the Germans. Of who was strong, and who weak. In the process she had, in effect, unearthed America’s scariest financial places.

“So what’s the scariest state?” I asked her.  
She had to think for only about two seconds.  
“California.”

### California Iron Man

**A**t seven o’clock one summer morning I pedaled a \$5,000 titanium-frame mountain bike rented in anxiety the previous evening down the Santa Monica beach road to the corner where Arnold Schwarzenegger had asked me to meet him. He turned up right on time, driving a black Cadillac S.U.V. with a handful of crappy old jalopy bikes racked to the back. I wore the closest I could find to actual bicycle gear; he wore a green fleece, shorts, and soft beige slipper-like shoes that suggested both a surprising indifference to his own appearance and a security in his own manhood. His hair was still vaguely in a shape left by a pillow, and his eyelids drooped, though he swore he’d been up for an hour and a half reading newspapers. After reading the newspapers, this is what the former governor of California often does: rides his bike for cardio, then hits the weight room.

He hauls a bike off the back of the car, hops on, and takes off down an already busy Ocean Avenue. He wears no bike helmet, runs red lights, and rips past DO NOT ENTER signs without seeming to notice them and up one-way streets the wrong way. When he wants to cross three lanes of fast traffic he doesn’t so much as glance over his shoulder but just sticks out his hand and follows it, assuming that whatever is behind him will stop. His bike has at least 10 speeds, but he has just 2: zero and pedaling as fast as he can. Inside half a mile he’s moving fast enough that wind-induced tears course down his cheeks.

He’s got to be one of the world’s most recognizable people, but he doesn’t appear to worry that anyone will recognize him, and no one does. It may be that people who get out of bed at dawn to jog and Rollerblade and racewalk are too interested in what they are doing to break their trance. Or it may be that he’s taking them by surprise. He has no entourage, not even a bodyguard. His former economic adviser, David Crane, and his media adviser, Adam Mendelsohn, who came along for the ride just because it sounded fun, are now somewhere far behind him. Anyone paying attention would think, That guy might look like Arnold, but it can’t possibly be Arnold, because Arnold would never be out alone on a bike at seven in the morning, trying to commit suicide. It isn’t until he is forced to stop at a red light that he makes meaningful contact with the public. A woman pushing a baby stroller and talking on a cell phone crosses the street right in front of him and

does a double take. “Oh . . . my . . . God,” she gasps into her phone. “It’s Bill Clinton!” She’s not 10 feet away, but she keeps talking to the phone, as if the man were unreal. “I’m here with Bill Clinton.”

“It’s one of those guys who has had a sex scandal,” says Arnold, smiling.

“Wait . . . wait,” says the woman to her phone. “Maybe it’s not Bill Clinton.”

Before she can make a positive identification, the light is green, and we’re off.

His life has been a series of carefully staged experiences. He himself has no staged presentation of it, however. He is fresh, alive, and improvisational: I’m not sure even he knows what he will do next. He’s not exactly humble, but then, if I had lived the life he’s lived, I’m not sure I would be, either, though I might try to fake humility more often than he does, which is roughly never. What saves him from self-absorption, aside from a natural curiosity, is a genuine lack of interest in personal reflection. He lives the same way he rides his bike, paying far more attention to what’s ahead than what’s behind. In office, he kept no journal of any sort. I find it amazing, but he now says he didn’t so much as scribble little notes that might later be used to reconstruct his experience and his feelings about it. “Why would I do that?” he says. “It’s kind of like you come home and your wife asks you about your day. I’ve done it once and I don’t want to do it again.” What he wanted to do after a long day of being governor, more or less, was to lift weights.

**W**e’re just a couple of miles in when he zips around a corner and into a narrow alleyway just off Venice Beach. He’s humoring me; I’ve been pestering him about what it was like for him when he first arrived in America, back in 1968, with little money, less English, really nothing but his lats, pecs, traps, and abs, for which there was no obvious market. He stops beside a tall brick wall. It surrounds what might once have been an impressive stone house that now just looks old and bleak and empty. The wall is what interests him, be-

cause he built it 43 years ago, right after he had arrived and started to train on Muscle Beach. “Franco [Columbu, like Schwarzenegger a former Mr. Olympia] and I made money this way. In bodybuilding there was no money. Here we were, world champions of this little subculture, and we did this to eat. Franco ran the business. I mixed the cement and knocked things down with the sledgehammer.”

Before he stumbled while running downhill with a refrigerator strapped to his back, Columbu was the front-runner in the 1977 contest for the title of the World’s Strongest Man, so there was some distinction in being hired by his operation, as Schwarzenegger was, to be the muscle. They had a routine. Franco would play the unreliable Italian, Arnold the sober German. Before they cut any deal they’d scream at each other in German in front of the customer until the customer would finally ask what was going on. Arnold would turn to the customer and explain, *Oh, he’s Italian, and you know how they are. He wants to charge you more, but I think we can do it cheaply.* Schwarzenegger would then name a not so cheap price. “And the

ing to do?” he says, dodging vagrants and joggers along the beach bike path. “I thought about it but decided I wasn’t going to do it. I told Maria I wasn’t running. I told everyone I wasn’t running. I wasn’t running.” Then, in the middle of the recall madness, *Terminator 3: Rise of the Machines* opened. As the movie’s leading machine, he was expected to appear on *The Tonight Show* to promote it. En route he experienced a familiar impulse—the impulse to do something out of the ordinary. “I just thought, This will freak everyone out,” he says. “It’ll be so funny. I’ll announce that I am running. I told Leno I was running. And two months later I was governor.” He looks over at me, pedaling as fast as I can to keep up with him, and laughs. “What the fuck is *that*?”

We’re now off the beach and on the surface roads, and the traffic is already heavy. He veers left, across four lanes, arrives on the other side, and says, “All these people are asking me, ‘What’s your plan? Who’s on your staff?’ I didn’t have a plan. I didn’t have a staff. I wasn’t running until I went on *Jay Leno*.”

## “OUR PASSIONS ARE STILL DRIVEN BY THE [BRAIN’S] LIZARD CORE. WE ARE SET UP TO ACQUIRE AS MUCH AS WE CAN,” SAYS DR. PETER WHYBROW.

customer,” he says now, laughing, “he would always say, ‘Arnold, you’re such a nice guy! So honest!’ It was selling, you know.”

He surveys his handiwork. “It’ll be here for a thousand years,” he says, then points out some erosion on the top. “I said to Franco we ought to come back and fix the top. You know, to show it was guaranteed for life.”

A poor kid from a small village in Austria, the son of a former Nazi, hops on a plane to America, starts out laying bricks, and winds up running the state and becoming one of America’s most prominent political leaders. From post to wire the race takes less than 35 years. I couldn’t help but ask the obvious question.

“If someone had told you when you were building this wall that you would wind up governor of California, what would you have said?”

“That would be all right,” he said, not exactly catching my drift.

“As a boy,” I said, taking another tack, “did you believe you’d lead something other than an ordinary life?”

“Yes.” He didn’t miss a beat.

“Why?”

“I don’t know.”

“No one has had this kind of crazy, wild ride,” he says as we speed away from the brick wall, but in a tone that suggests the ride was an accident. “I was influenced a lot by America,” he said. “The giant six-lane highways, the Empire State Building, the risk-taking.” He still remembers vividly the America he heard and read about as a boy in Austria: everything about it was big. The only reason he set out to grow himself some big muscles was that he thought it might be a ticket to America.

If there had not been a popular movement to remove sitting governor Gray Davis and the chance to run for governor without having to endure a party primary, he never would have bothered. “The recall happens and people are asking me, ‘What are you go-

His view of his seven years trying to run the state of California can be summarized as follows. He came to power accidentally, but not without ideas about what he wanted to do. At his core he thought government had become more problem than solution: an institution run less for the benefit of the people than for the benefit of politicians and other public employees. He behaved pretty much as Americans seem to imagine the ideal politician should behave: he made bold decisions without looking at polls; he didn’t sell favors; he treated his opponents fairly; he was quick to acknowledge his mistakes and to learn from them; and so on. He was the rare elected official who believed, with some reason, that he had nothing to lose, and behaved accordingly. When presented with the chance to pursue an agenda that violated his own narrow political self-interest for the sake of the public interest, he tended to leap at it. “There were a lot of times when we said, ‘You just can’t do that,’” says his former chief of staff, Susan Kennedy, a lifelong Democrat, whose hiring was one of those things a Republican governor was not supposed to do. “He was always like, ‘I don’t care.’ Ninety percent of the time it was a good thing.”

Two years into his tenure, in mid-2005, he’d tried everything he could think of to persuade individual California state legislators to vote against the short-term desires of their constituents for the greater long-term good of all. “To me there were shocking moments,” he says. Having sped past a DO NOT ENTER sign, we are now flying through intersections without pausing. I can’t help but notice that, if we weren’t breaking the law by going the wrong way down a one-way street, we’d be breaking the law by running stop signs. “When you want to do pension reform for the prison guards,” he says, “and all of a sudden *the Republicans* are all lined up against you. It was really incredible, and it happened over and over: people would say to me, ‘Yes, this is the best idea! I would love to vote for it! But if I vote for it some interest group is going to be angry with me, so I won’t do it.’ I couldn’t believe people could actu-

# IT'S A LONESOME OLD TOWN

ally say that. You have soldiers dying in Iraq and Afghanistan, and they didn't want to risk their political lives by doing the right thing."

He came into office with boundless faith in the American people—after all, they had elected him—and figured he could always appeal directly to them. That was his trump card, and he played it. In November 2005 he called a special election that sought votes on four reforms: limiting state spending, putting an end to the gerrymandering of legislative districts, limiting public-employee-union spending on elections, and lengthening the time it took for public-school teachers to get tenure. All four propositions addressed, directly or indirectly, the state's large and growing financial mess. All four were defeated; the votes weren't even close. From then until the end of his time in office he was effectively gelded: the legislators now knew that the people who had elected them to behave exactly the way they were already behaving were not going to undermine them when appealed to directly. The people of California might be irresponsible, but at least they were consistent.

## Home of the Free . . . Lunch

**A** compelling book called *California Crack-up* describes this problem more generally. It was written by a pair of journalists and nonpartisan think-tank scholars, Joe Mathews and Mark Paul, and they explain, among other things, why Arnold Schwarzenegger's experience as governor was going to be unlike any other experience in his career: he was never going to win. California had organized itself, not accidentally, into highly partisan legislative districts. It elected highly partisan people to office and then required these people to reach a two-thirds majority to enact any new tax or meddle with big spending decisions. On the off chance that they found some common ground, it could be pulled out from under them by voters through the initiative process. Throw in term limits—no elected official now serves in California government long enough to fully understand it—and you have a recipe for generating maximum contempt for elected officials. Politicians are elected to get things done and are prevented by the system from doing it, leading the people to grow even more disgusted with them. "The vicious cycle of contempt," as Mark Paul calls it. California state government was designed mainly to maximize the likelihood that voters will continue to despise the people they elect.

But when you look below the surface, he adds, the system is actually very good at giving Californians what they want. "What all the polls show," says Paul, "is that people want services and not to pay for them. And that's exactly what they have now got." As much as they claimed to despise their government, the citizens of California shared its defining trait: a need for debt. The average Californian, in 2011, had debts of \$78,000 against an income of \$43,000. The behavior was unsustainable, but, in its way, for the people, it works brilliantly. For their leaders, even in the short term, it works less well. They ride into office on great false hopes and quickly discover they can do nothing to justify those hopes.

In Paul's view, Arnold Schwarzenegger had been the best test to date of the notion that the problem with California politics was personal, that all the system needed to fix itself was an independent-minded leader willing to rise above petty politics and exert the will of the people. "The recall was, in and of itself, an effort by the people to say that a new governor—a different

**@vf.com**  
Q&A WITH  
MICHAEL  
LEWIS.

CONTINUED ON PAGE 222

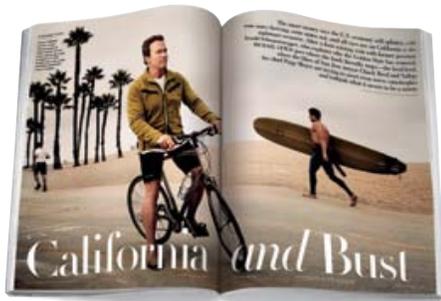


**I**t's a romantic idea: the secret artist, an unseen observer who fully registers and refines existence in majestic but unknown works. The notion hints at the great artist we all yearn to believe is concealed in each of us. Yet it happens. Witness Emily Dickinson. And now Vivian Maier. Born in New York in 1926, but raised in France, in the 1950s Maier arrived in Chicago, where she lived an insular life and worked for decades as a nanny (before her death, at age 83, in 2009). On her off days and vacations, she wandered with a Rolleiflex. Her arresting photographs, mostly in black and white, were discovered in 2007 when John Maloof, a young Chicago real-estate agent, who has since become Maier's relentless champion, bought a box of negatives, auctioned from an abandoned storage locker. Many of those pictures—showcased in the new book *Vivian Maier: Street Photographer*, out this month from Powerhouse—rivet the viewer with the extreme vulnerability of her subjects. Some, such as Salvador Dalí, face the lens with a naked look. More often, Maier, unobserved, captured the vivid oddities of urban life: a man who powers down the street trying to look like Popeye; a young boy riding a horse bareback under elevated tracks; a fully clothed man asleep on the beach. She recorded the fabled harshness of 50s Chicago in the image of a vagrant coiled by hopelessness, or a drunk being dragged down the street by police. In an era that celebrates our intricate network of virtual connections, Maier's work and her biography are starkly moving reminders of how powerfully we all experience our lives, largely in isolation.

Stolen moment:  
January 9, 1957,  
Florida.

—SCOTT TUROW

# California



CONTINUED FROM PAGE 183 person—could solve the problem,” says Paul. “He tried every different way of dealing with the crisis in services. He tried to act like a Republican. He tried to act like a Democrat. He tried making nice with the legislature. When that didn’t work he called them girlie men. When that didn’t work he went directly to the people. And the people voted against his proposals.”

The experiment wasn’t a complete failure. As governor, Schwarzenegger was able to accomplish a few important things—reforming worker compensation, enabling open primaries, and, at the very end, ensuring that legislative districts would be drawn by an impartial committee rather than by the legislature. But on most issues, and on virtually everything having to do with how the state raised and spent money, he lost. In his first term Schwarzenegger had set out to cut spending and found he could cut only the things that the state actually needed. Near the end of his second term, he managed to pass a slight tax increase, after he talked four Republicans into creating the super-majority necessary for doing so. Every one of them lost his seat in the next election. He’d taken office in 2003 with approval ratings pushing 70 percent and what appeared to be a mandate to fix California’s money problems; he left in 2011 with approval ratings below 25 percent, having fixed very little. “I was operating under the commonsense kind of thing,” he says now. “It was the voters who recalled Gray Davis. It was the voters who elected me. So it will be the voters who hand me the tools to do the job. But the other side was successful enough for the voters to take the tools away.”

David Crane, the former economic adviser—at that moment rapidly receding into the distance—could itemize the result: a long list of depressing government financial statistics. The pensions of state employees ate up twice as much of the budget when Schwarzenegger left office as they had when he arrived, for instance. The officially recognized gap between what the state would owe its workers and what it had on hand to pay them was roughly \$105 billion, but that, thanks to ac-

counting gimmicks, was probably only about half the real number. “This year the state will directly spend \$32 billion on employee pay and benefits, up 65 percent over the past 10 years,” says Crane later. “Compare that to state spending on higher education [down 5 percent], health and human services [up just 5 percent], and parks and recreation [flat], all crowded out in large part by fast-rising employment costs.” Crane is a lifelong Democrat with no particular hostility to government. But the more he looked into the details, the more shocking he found them to be. In 2010, for instance, the state spent \$6 billion on fewer than 30,000 guards and other prison-system employees. A prison guard who started his career at the age of 45 could retire after five years with a pension that very nearly equaled his former salary. The head parole psychiatrist for the California prison system was the state’s highest-paid public employee; in 2010 he’d made \$838,706. The same fiscal year that the state spent \$6 billion on prisons, it had invested just \$4.7 billion in its higher education—that is, 33 campuses with 670,000 students. Over the past 30 years the state’s share of the budget for the University of California has fallen from 30 percent to 11 percent, and it is about to fall a lot more. In 1980 a Cal student paid \$776 a year in tuition; in 2011 he pays \$13,218. Everywhere you turn, the long-term future of the state is being sacrificed.

This same set of facts, and the narrative it suggested, would throw an ordinary man into depression. He might conclude that he lived in a society that was ungovernable. After seven years of trying and mostly failing to run California, Schwarzenegger is persuasively not depressed. “You have to realize the thing was so much fun!” he says. “We had a great time! There were times of frustration. There were times of disappointment. But if you want to live rather than just exist, you want the drama.” As we roll to a stop very near the place on the beach where he began his American bodybuilding career, he says, “You have to step back and say, ‘I was elected under odd circumstances. And I’m going out in odd circumstances.’ You can’t have it both ways. You can’t be a spoiled brat.”

The odd circumstances were the never-ending financial crises. He’d come to power in the bust after the Internet bubble; he’d left in the bust after the housing bubble. Before and after our bike ride, I sat down with him to get his view of this second event. It was in the middle of 2007, he said, when he first noticed something was not quite right in the California economy. He’d been finishing up budget negotiations and arrived at a number, however phony, where the budget could be declared balanced. An aide walked into his office to give him a heads-up: the tax receipts for that month were less than expected. “We were

all of a sudden short \$300 million in revenue for the month,” says Schwarzenegger. “I somehow felt, Uh-oh. Because there was something in the air.” Soon after that he visited the George W. Bush White House, where he gave a talk that was, as ever, upbeat. “At the end of it this guy—he was the guy who was in charge of housing, I forgot the name. Great guy. For some reason or other he was very honest with me. I don’t know why. He probably didn’t think I’d go out and blab, which I didn’t. He says, ‘That was a great speech you gave, but we’re heading to a major problem.’ I said, ‘What do you mean?’ He said, ‘I looked at some of the numbers, and it’s going to be ugly.’ That’s all he said. He wouldn’t elaborate.” A housing-price decline in the United States meant a housing-price collapse in California, and a housing-price collapse in California meant an economic collapse and a decline in tax revenues. “The next month our revenues came in short \$600 million. By December we were short a billion.”

At some point in our talks I asked Schwarzenegger how much time he had spent, as governor, grappling with the on-the-ground local implications of the big state crisis. The question pretty clearly bored him. “I’m not into the local stuff,” he’d said. “I was born for the world.”

## City of Broken Dreams

About an hour into the weekly meeting of the San Jose City Council, I find myself wishing that I, too, was born for the world. A hundred citizens yawn and text as the council honors National Farmers Market Week; the few people who seem to be paying attention get up and leave after the honor is bestowed. The council commemorates August 7 as Assyrian Martyrs Day, “honoring the massacre of three thousand people in August 1933, and recognizing 2,000 years of persecution of Assyrian Christians.” Maybe 30 people turn their attention from their cell phones to the ceremony, but then they, too, rise and exit the chamber. A mere handful of people are left to hear the San Jose city manager offer the latest bleak financial news: the state of California was clawing back tens of millions of dollars more, and “140 employees have been separated from the city.” (New times call for new euphemisms.) A pollster presents his finding that, no matter how the question is phrased, the citizens of San Jose are unlikely to approve any ballot measure that raises taxes. A numbers guy gets to his feet and explains that the investment returns in the city’s pension plan are not likely to be anything near as high as was assumed. In addition to there not being enough money in this particular pot to begin with, the pot is failing to expand as fast as everyone had hoped, and so the gap between what the city’s employees are entitled to and what will exist is even greater than previously imagined. The

council then votes to postpone, for six weeks, a vote on whether to declare the city's budget a "public emergency," and thus to give to the mayor, Chuck Reed, new powers.

Following each motion an obese man not so much dressed as enshrouded in blue-jean overalls maximizes his right to be heard for five minutes on every subject: over and again he rises from the front row of the audience, waddles to the podium, and delivers sophisticated-sounding but incomprehensible critiques of everything. "*The absolute reduction in competence of government is predicated on what happened today...*"

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. San Jose has the highest per capita income of any city in the United States, after New York. It has the highest credit rating of any city in California with a population over 250,000. It is one of the few cities in America with a triple-A rating from Moody's and Standard & Poor's, but only because its bondholders have the power to compel the city to levy a tax on property owners to pay off the bonds. The city itself is not all that far from being bankrupt.

It's late afternoon when I meet Mayor Chuck Reed in his office at the top of the city-hall tower. The crowd below has just begun to chant. The public employees, as usual, are protesting him. Reed is so used to it that he hardly notices. He's a former air-force officer and Vietnam-era veteran with an intellectual bent and the clipped manner of a midwestern farmer. He has a master's degree from Princeton, a law degree from Stanford, and a lifelong interest in public policy. Still, he presents less as the mayor of a big city in California than as a hard-bitten, upstanding sheriff of a small town who doesn't want any trouble. Elected to the city council in 2000, he became mayor six years later; in 2010 he was re-elected with 77 percent of the vote. He's a Democrat, but at this point it doesn't much matter which party he belongs to, or what his ideological leanings are, or for that matter how popular he is with the people of San Jose. He's got a problem so big that it overwhelms ordinary politics: the city owes so much more money to its employees than it can afford to pay that it could cut its debts in half and still wind up broke. "I did a calculation of cost per public employee," he says as we settle in. "We're not as bad as Greece, I don't think."

The problem, he explains, pre-dates the most recent financial crisis. "Hell, I was here. I know how it started. It started in the 1990s with the Internet boom. We live near rich people, so we thought we were rich." San Jose's budget, like the budget of any city, turns on the pay of public-safety workers: the police and firefighters now eat 75 percent of all discretionary spending. The Internet

boom created both great expectations for public employees and tax revenues to meet them. In its negotiations with unions the city was required to submit to binding arbitration, which works for police officers and firefighters just as it does for Major League Baseball players. Each side of any pay dispute makes its best offer, and a putatively neutral judge picks one of them. There is no meeting in the middle: the judge simply rules for one side or the other. Each side thus has an incentive to be reasonable, for the less reasonable they are, the less likely it is that the judge will favor their proposal. The problem with binding arbitration for police officers and firefighters, says Reed, is that the judges are not neutral. "They tend to be labor lawyers who favor the unions," he says, "and so the city does anything it can to avoid the process." And what politician wants to spat publicly with police officers and firefighters?

Over the past decade the city of San Jose had repeatedly caved to the demands of its public-safety unions. In practice this meant that when the police or fire department of any neighboring city struck a better deal for itself, it became a fresh argument for improving the pay of San Jose police and fire. The effect was to make the sweetest deal cut by public-safety workers with any city in Northern California the starting point for the next round of negotiations for every other city. The departments also used each other to score debating points. For instance, back in 2002, the San Jose police union cut a three-year deal that raised police officers' pay by 18 percent over the contract. Soon afterward, the San Jose firefighters cut a better deal for themselves, including a pay raise of more than 23 percent. The police felt robbed and complained mightily until the city council crafted a deal that handed them 5 percent more premium pay in exchange for training to fight terrorists. "We got famous for our anti-terrorist-training pay," explains one city official. Eventually the anti-terrorist-training premium pay stopped; the police just kept the extra pay, with benefits. "Our police and firefighters will earn more in retirement than they did when they were working," says Reed. "There used to be an argument that you have to give us money or we can't afford to live in the city. Now the more you pay them the less likely they are to live in the city, because they can afford to leave. It's staggering. When did we go from giving people sick leave to letting them accumulate it and cash it in for hundreds of thousands of dollars when they are done working? There's a corruption here. It's not just a financial corruption. It's a corruption of the attitude of public service."

When he was elected to the city council, Reed says, "I hadn't even thought about pensions. I can't say I said, 'Here is my plan.' I never thought about this stuff. It never came

up." It wasn't until San Diego flirted with bankruptcy, in 2002, that he wondered about San Jose's finances. He began to investigate the matter. "That's when I realized there were big problems," he says. "That's when I started paying attention. That's when I started asking questions: Could it happen here? It's like the housing bubble and the Internet bubble. There were people around who were writing about it. It's not that there aren't people telling us that this is crazy. It's that you refuse to believe that you are crazy."

He hands me a chart. It shows that the city's pension costs when he first became interested in the subject were projected to run \$73 million a year. This year they would be \$245 million: pension and health-care costs of retired workers now are more than half the budget. In three years' time pension costs alone would come to \$400 million, though "if you were to adjust for real life expectancy it is more like \$650 million." Legally obliged to meet these costs, the city can respond only by cutting elsewhere. As a result, San Jose, once run by 7,450 city workers, was now being run by 5,400 city workers. The city was back to staffing levels of 1988, when it had a quarter of a million fewer residents. The remaining workers had taken a 10 percent pay cut; yet even that was not enough to offset the increase in the city's pension liability. The city had closed its libraries three days a week. It had cut back servicing its parks. It had refrained from opening a brand-new community center, built before the housing bust, because it couldn't pay to staff the place. For the first time in history it had laid off police officers and firefighters.

By 2014, Reed had calculated, a city of a million people, the 10th-largest city in the United States, would be serviced by 1,600 public workers. "There is no way to run a city with that level of staffing," he said. "You start to ask: What is a city? Why do we bother to live together? But that's just the start." The problem was going to grow worse until, as he put it, "you get to one." A single employee to service the entire city, presumably with a focus on paying pensions. "I don't know how far out you have to go until you get to one," said Reed, "but it isn't all that far." At that point, if not before, the city would be nothing more than a vehicle to pay the retirement costs of its former workers. The only clear solution was if former city workers up and died, soon. But former city workers were, blessedly, living longer than ever.

This wasn't a hypothetical scary situation, said Reed. "It's a mathematical inevitability." In spirit it reminded me of Bernard Madoff's investment business. Anyone who looked at Madoff's returns and understood them could see he was running a Ponzi scheme; only one person who had understood them bothered to blow the whistle, and no one listened to him. (See *No One Would Listen: A True*

# California

*Financial Thriller*, by Harry Markopolos.)

In his negotiations with the unions, the mayor has gotten nowhere. “I understand the police and firefighters,” he says. “They think, We’re the most important, and everyone else goes [gets fired] first.” The police union recently suggested to the mayor that he close the libraries for the other four days. “We looked into that,” Reed says. “If you close the libraries an extra day you pay for 20 or 30 cops.” Adding 20 more police officers for a year wouldn’t solve anything. The cops who were spared this year would be axed next, in response to the soaring costs of the pensions of city workers who already had retired. On the other side of the inequality is the taxpayer of San Jose, who has no interest in paying more than he already does. “It’s not that we’re insolvent and can’t pay our bills,” says Reed. “It’s about willingness.”

I ask him what the chances are that, in this pinch, he could raise taxes. He holds up a thumb and index finger: zero. He’s recently coined a phrase, he says: “service-level insolvency.” Service-level insolvency means that the expensive community center that has been built and named cannot be opened. It means closing libraries three days a week. It isn’t financial bankruptcy; it’s cultural bankruptcy.

“How on earth did this happen?” I ask him.

“The only way I can explain it,” he says, “is that they got the money because it was there.” But he has another way to explain it, and in a moment he offers it up.

“I think we’ve suffered from a series of mass delusions,” he says.

I didn’t completely understand what he meant, and said so.

“We’re all going to be rich,” he says. “We’re all going to live forever. All the forces in the state are lined up to preserve the status quo. To preserve the delusion. And here—this place—is where the reality hits.”

On the way back to the elevators I chat with two of Mayor Reed’s aides. He’d mentioned to me that, as bad as they might think they have it in San Jose, a lot of other American cities have it worse. “I count my blessings when I talk to the mayors of other cities,” he’d said.

“Which city do you pity most?” I ask just before the elevator doors close.

They laugh and in unison say, “Vallejo!”

## Living on the Default Line

WELCOME TO VALLEJO, CITY OF OPPORTUNITY, reads the sign on the way in, but the shops that remain open display signs that say, WE ACCEPT FOOD STAMPS. Weeds surround abandoned businesses, and all traffic lights are set to permanently blink, which is a formality, as there are no longer any cops to police the streets. Vallejo is the one city in

the Bay Area where you can park anywhere and not worry about getting a ticket, because there are no meter maids either. The windows of city hall are dark, but its front porch is a hive of activity. A young man in a backward baseball cap, sunglasses, and a new pair of Nike sneakers stands on a low wall and calls out an address:

“Nine hundred Cambridge Drive,” he says. “In Benicia.”

The people in the crowd below instantly begin bidding. From 2006 to 2010 the value of Vallejo real estate fell 66 percent. One in 16 homes in the city is in foreclosure. This is apparently the fire sale, but the characters involved are so shady and furtive that I can hardly believe it. I stop to ask what’s going on, but the bidders don’t want to talk. “Why would I tell you anything?” says a guy sitting in a Coleman folding chair. He obviously thinks he’s shrewd, and perhaps he is.

The lobby of city hall is completely empty. There’s a receptionist’s desk but no receptionist. Instead, there’s a sign: TO FORECLOSURE AUCTIONEERS AND FORECLOSURE BIDDERS: PLEASE DO NOT CONDUCT BUSINESS IN THE CITY HALL LOBBY.

On the third floor I find the offices of the new city manager, Phil Batchelor, but when I walk in, there is no one in sight. It’s just a collection of empty cubicles. At length a woman appears and leads me to Batchelor himself. He’s in his 60s and, oddly enough, a published author. He’s written one book on how to raise children and another on how to face death. Both deliver an overtly Christian message, but he doesn’t come across as Evangelical; he comes across as sensible, and a little weary. His day job, before he retired, was running cities with financial difficulties. He came out of retirement to take this job, but only after the city council had asked him a few times. “The more you say no, the more determined they are to get you,” he says. His chief demand was not financial but social: he’d take the job only if the people on the city council ceased being nasty to one another and behaved civilly. He actually got that in writing, and they’ve kept their end of the bargain. “I’ve been in a lot of places that have been in a lot of trouble, but I’ve never seen anything like this,” he says. He then lays out what he finds unusual, beginning with the staffing levels. He’s now running the city, and he has a staff of one: I just met her. “When she goes out to the bathroom, she has to lock the [office] door,” he says, “because I’m in meetings, and we have no one else.”

Back in 2008, unable to come to terms with its many creditors, Vallejo declared bankruptcy. Eighty percent of the city’s budget—and the lion’s share of the claims that had thrown it into bankruptcy—were wrapped up in the pay and benefits of public-safety workers. Relations between

the police and the firefighters, on the one hand, and the citizens, on the other, were at historic lows. The public-safety workers thought that the city was out to screw them on their contracts; the citizenry thought that the public-safety workers were using fear as a tool to extort money from them. The local joke was that “P.D.” stands for “Pay or Die.” The city-council meetings had become exercises in outrage: at one, a citizen arrived with a severed pig’s head on a barbecue grill. “There’s no good reason why Vallejo is as fucked up as it is,” says longtime resident Marc Garman, who created a Web site to catalogue the civil war. “It’s a boat ride to San Francisco. You throw a stone and you hit Napa.” Since the bankruptcy, the police and fire departments have been cut in half; some number of the citizens who came to Phil Batchelor’s office did so to say they no longer felt safe in their own homes. All other city services had been reduced effectively to zero. “Do you know that some cities actually pave their streets?” says Batchelor. “That’s not here.”

I notice on his shelf a copy of *Fortune* magazine, with Meredith Whitney on the cover. And as he talked about the bankrupting of Vallejo, I realized that I had heard this story before, or a private-sector version of it. The people who had power in the society, and were charged with saving it from itself, had instead bled the society to death. The problem with police officers and firefighters isn’t a public-sector problem; it isn’t a problem with government; it’s a problem with the entire society. It’s what happened on Wall Street in the run-up to the subprime crisis. It’s a problem of people taking what they can, just because they can, without regard to the larger social consequences. 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. Alone in a dark room with a pile of money, Americans knew exactly what they wanted to do, from the top of the society to the bottom. They’d been conditioned to grab as much as they could, without thinking about the long-term consequences. Afterward, the people on Wall Street would privately bemoan the low morals of the American people who walked away from their subprime loans, and the American people would express outrage at the Wall Street people who paid themselves a fortune to design the bad loans.

Having failed to convince its public-safety workers that it could not afford to make them rich, the city of Vallejo, California, had hit bottom: it could fall no lower. “My approach has been I don’t care who is to blame,” Batchelor said. “We needed to change.” When I met him, a few months after he had taken the job, he was still trying to resolve a narrow financial dispute: the city

had 1,013 claimants with half a billion dollars in claims but only \$6 million to dole out to them. They were survivors of a shipwreck on a life raft with limited provisions. His job, as he saw it, was to convince them that the only chance of survival was to work together. He didn't view the city's main problem as financial: the financial problems were the symptom. The disease was the culture. Just a few weeks earlier, he had sent a memo to the remaining city staff—the city council, the mayor, the public-safety workers. The central message was that if you want to fix this place you need to change how you behave, each and every one of you. "It's got to be about the people," he said. "Teach them respect for each other, integrity and how to strive for excellence. Cultures change. But people need to want to change. People convinced against their will are of the same opinion still."

"How do you change the culture of an entire city?" I asked him.

"First of all we look internally," he said.

### Too Fat to Fly

The road out of Vallejo passes directly through the office of Dr. Peter Whybrow, a British neuroscientist at U.C.L.A. with a theory about American life. He thinks the dysfunction in America's society is a by-product of America's success. In academic papers and a popular book, *American Mania*, Whybrow argues, in effect, that human beings are neurologically ill-designed to be modern Americans. The human brain evolved over hundreds of thousands of years in an environment defined by scarcity. It was not designed, at least originally, for an envi-

ronment of extreme abundance. "Human beings are wandering around with brains that are fabulously limited," he says cheerfully. "We've got the core of the average lizard." Wrapped around this reptilian core, he explains, is a mammalian layer (associated with maternal concern and social interaction), and around that is wrapped a third layer, which enables feats of memory and the capacity for abstract thought. "The only problem," he says, "is our passions are still driven by the lizard core. We are set up to acquire as much as we can of things we perceive as scarce, particularly sex, safety, and food." Even a person on a diet who sensibly avoids coming face-to-face with a piece of chocolate cake will find it hard to control himself if the chocolate cake somehow finds him. Every pastry chef in America understands this, and now neuroscience does, too. "When faced with abundance, the brain's ancient reward pathways are difficult to suppress," says Whybrow. "In that moment the value of eating the chocolate cake exceeds the value of the diet. We cannot think down the road when we are faced with the chocolate cake."

The richest society the world has ever seen has grown rich by devising better and better ways to give people what they want. The effect on the brain of lots of instant gratification is something like the effect on the right hand of cutting off the left: the more the lizard core is used the more dominant it becomes. "What we're doing is minimizing the use of the part of the brain that lizards don't have," says Whybrow. "We've created physiological dysfunction. We have lost the ability to self-regulate, at all levels of the so-

ciety. The \$5 million you get paid at Goldman Sachs if you do whatever they ask you to do—that is the chocolate cake upgraded."

The succession of financial bubbles, and the amassing of personal and public debt, Whybrow views as simply an expression of the lizard-brained way of life. A color-coded map of American personal indebtedness could be laid on top of the Centers for Disease Control's color-coded map that illustrates the fantastic rise in rates of obesity across the United States since 1985 without disturbing the general pattern. The boom in trading activity in individual stock portfolios; the spread of legalized gambling; the rise of drug and alcohol addiction—it is all of a piece. Everywhere you turn you see Americans sacrifice their long-term interests for short-term rewards.

What happens when a society loses its ability to self-regulate, and insists on sacrificing its long-term interest for short-term rewards? How does the story end? "We could regulate ourselves if we chose to think about it," Whybrow says. "But it does not appear that is what we are going to do." Apart from that remote possibility, Whybrow imagines two outcomes. The first he illustrates with a true story, which might be called the parable of the pheasant. Last spring, on sabbatical from the University of Oxford, he was surprised to discover that he was able to rent an apartment inside Blenheim Palace, the Churchill family home. The previous winter at Blenheim had been harsh, and the pheasant hunters had been efficient; as a result, just a single pheasant had survived in the palace gardens. This

## SKETCHBOOK: RIMBAUD RAMBO BY ISTVAN BANYAI



# California

bird had gained total control of a newly seeded field. Its intake of food, normally regulated by its environment, was now entirely unregulated: it could eat all it wanted, and it did. The pheasant grew so large that, when other birds challenged it for seed, it would simply frighten them away. The fat pheasant became a tourist attraction and even acquired a name: Henry. “Henry was the biggest pheasant anyone had ever seen,” says Whybrow. “Even after he got fat, he just ate and ate.” It didn’t take long before Henry was obese. He could still eat as much as he wanted, but he could no longer fly. Then one day he was gone: a fox ate him.

The other possible outcome was only slightly more hopeful: to hit bottom. To realize what has happened to us—because we have no other choice. “If we refuse to regulate ourselves, the only regulators are our environment,” says Whybrow, “and the way that environment deprives us.” For meaningful change to occur, in other words, we need the environment to administer the necessary level of pain.

In August 2011, the same week that Standard & Poor’s downgraded the debt of the United States government, a judge approved the bankruptcy plan for Vallejo, California. Vallejo’s creditors ended up with 5 cents on the dollar, public employees with something like 20 and 30 cents on the dollar. The city no longer received any rating at all from Moody’s and Standard & Poor’s. It would take years to build the track record needed to obtain a decent rating. The absence of a rating mattered little, as the last thing the city needed to do was to go out and borrow money from strangers.

More out of idle curiosity than with any clear purpose, I drove up again to Vallejo and paid a call on the fire department. In the decay of our sense of common purpose, the firefighters are a telling sign that we are approaching a new bottom. It isn’t hard to imagine how a police department might wind up in conflict with the community it’s hired to protect. A person who becomes a police officer enjoys the authority. He wants to stop the bad guys. He doesn’t necessarily need to care for the people he polices. A person who becomes a firefighter wants to be a good guy. He wants to be *loved*.

The Vallejo firefighter I met with that morning was named Paige Meyer. He was 41 years old. He had short salt-and-pepper hair and olive skin, with traces of burn marks on his cheeks. His natural expression was a smile. He wasn’t particularly religious or political. (“I’m not necessarily a God guy.”) The closest thing he had to a religion, apart from his family, was his job. He was extremely proud of it, and of his colleagues. “I don’t want this to sound arrogant at all,” he said, “but many departments in nicer communities, they get a serious fire maybe once a year. We get them

all the time.” The Vallejo population is older and poorer than in many surrounding cities, and older still are the buildings it lives in. The typical Vallejo house is a charming, highly flammable wooden Victorian. “In this town we fight fires,” says Meyer. “This town *rips*.” The department was shaped by its environment: they were extremely aggressive firefighters. “When I came to this department you *rolled* to a fire,” he said. “You were not going to see an exterior water stream from this department. We’re going in. You have some knucklehead calling in with a sore throat—your giddyup is not so fast. But I’ll tell you something about this department. They get a call that there’s a baby choking or a 10-year-old not breathing, you better get out of the way or you’re going to get run over.”

As a young man, to pay his way through college, Meyer had worked as a state-beach lifeguard at lakes in central California. He assumed that there would be little drama in the work but people would turn up, get drunk, and attempt to drown. A few of the times he pulled people from the water, they were in bad enough shape that they needed paramedics; the fire department was there on the spot. He started talking to firefighters and found that “they all absolutely loved what they did. You get to go and *live* and create a second family. How can you not like that?” He came to Vallejo in 1998, at the age of 28. He had left a cushy job in Sunnyvale, outside San Jose, where there aren’t many fires, precisely because he wanted to fight fires. “In other departments,” he says, “I wasn’t a firefighter. The first six months of the job here, I was out at two in the morning at a fire every other week. I couldn’t believe it.” The houses of Vallejo are mainly balloon-frame construction. The interior walls have no firebreaks: from bottom to top, all four walls carry fire as efficiently as a chimney. One of the rookie mistakes in Vallejo is to put the fire out on the ground floor, only to look up and see it roaring out of the roof. “When we get to a fire we say, ‘Boom! Send someone up to the attic.’ Because the fire is going right to the attic.”

Meyer actually had made that rookie mistake. One day not long after he’d arrived, he jumped off the truck already breathing air from a tank and raced into what appeared to be a burning one-bedroom apartment. He knocked down the door and put the attack line on the fire and then wondered why the fire wasn’t going out. “It should have been getting cooler, but it was getting hotter and hotter.” Right in front of his face, on his plastic mask, lines trickled down, like rain on a windshield. The old-school firefighters left their ears exposed so they could feel the heat: the heat contained the critical information. Meyer could only see the heat: his helmet was melting. “If your helmet starts to shrivel up and melt, that’s not cool,” he says. A melting

helmet, among the other problems it presents, is an indication that a room is about to flash. Flashing, he explains, “is when all combustible materials simultaneously ignite. You’re a baked potato after that.” He needed more water, or to get out, but his ego was invested in staying inside, and so he stayed inside. Moments later a backup arrived, with another, bigger hose.

Afterward, he understood his mistake: the building was three stories, built on a slope that disguised its size, and the fire had reached the attic. “I’m not saying that if the backup hadn’t come when it did I’d be dead,” he says, but that’s exactly what he is saying. The scar on his face is from that fire. “I needed to learn to control my environment,” he said. “I’d had this false sense of security.”

When you take care of something, you become attached to it, and he’d become attached to Vallejo. He was extremely uncomfortable with conflict between his union and the citizens, and had found himself in screaming matches with the union’s negotiator. Meyer thought firefighters, who tended to be idealistic and trusting, were easily duped. He further thought the rank and file had been deceived both by the city, which lied to them repeatedly in negotiations, and by their own leadership, which harnessed the firefighters’ outrage to make unreasonable demands in the union-negotiated contract with the city. What was lost at the bargaining table was the reason they did what they did for a living. “I’m telling you,” Meyer says, “when I started, I didn’t know what I was getting paid. I didn’t care what I was getting paid. I didn’t know about benefits. A lot of things that we’re politicizing today were not even in my mind. I was just thinking of my dream job. Let me tell you something else: nobody cared in 2007 how much I made. If I made six figures they said, ‘Shit, man, you deserve it. You ran into a burning building.’ Because everyone had a job. All they knew about our job is that it was dangerous. The minute the economy started to collapse, people started looking at each other.”

Today the backup that may or may not have saved him is far less likely to arrive. When Vallejo entered bankruptcy, the fire department was cut from 121 to 67, for a city of 112,000 people. The department handles roughly 13,000 calls a year, extremely high for the population. When people feel threatened or worried by anything except other people, they call the fire department. Most of these calls are of the cat-in-the-tree variety—pointless. (“You never see the skeleton of a cat in a tree.”) They get calls from people who have headaches. They get calls from people who have itches where they can’t scratch. They have to answer every call. (“The best call I ever had was phantom-leg pain in a guy with no legs.”) To deal with these huge numbers of calls, they once had eight stations,

eight three-person engine companies, a four-man truck company (used only for actual fires and rescue calls), one fireboat, one confined-space rescue team, and a team to deal with hazardous materials. They now are down to four stations, four engines, and a truck.

This is particularly relevant to Paige Meyer because, two months ago, he became Vallejo's new fire chief. It surprised him: he hadn't even applied for the job. The city manager, Phil Batchelor, just called him to his office one day. "He didn't ever really ask me if I wanted the job," says Meyer. "He just asked how's the family, told me he was giving me the job, and asked if I had any problem with that."

He didn't, actually. He sat down and made a list of ways to improve the department. He faced a fresh challenge: How to deliver service that was the same as before, or even better than before, with half the resources. How

to cope with an environment of scarcity. He began to measure things that hadn't been measured. The No. 1 cause of death in firefighting was heart attacks. No. 2 was truck crashes. He was now in charge of a department that would be both overworked and in a hurry. Fewer people doing twice the work probably meant twice the number of injuries per firefighter. He'd decided to tailor fitness regimes to fit the job. With fewer fire stations and fewer firefighters in them, the response times were going to be slower. He'd need to find new ways to speed things up. A longer response time meant less room for error; a longer response time meant the fires they'd be fighting would be bigger. He had some thoughts about the most efficient way to fight these bigger fires. He began, in short, to rethink firefighting.

When people pile up debts they will find difficult and perhaps even impossible to repay, they are saying several things at once.

They are obviously saying that they want more than they can immediately afford. They are saying, less obviously, that their present wants are so important that, to satisfy them, it is worth some future difficulty. But in making that bargain they are implying that, when the future difficulty arrives, they'll figure it out. They don't always do that. But you can never rule out the possibility that they will. As idiotic as optimism can sometimes seem, it has a weird habit of paying off. □

## FROM THE ARCHIVE

For these related stories, visit [VF.COM/ARCHIVE](http://VF.COM/ARCHIVE)

### • Euro disasterland, Parts I through IV

(Michael Lewis, April 2009, October 2010, March 2011, September 2011)

### • Power couple: Arnold and Maria

(Marie Brenner, January 2005)

### • California's governor answers the Proust Questionnaire (July 2003)

## Courtney Love



CONTINUED FROM PAGE 205 went on tour with Hole. Their album *Live Through This* had been released four days after Cobain died. It's interesting that, while conspiracy theories have formed around the timing of Cobain's death vis-à-vis Courtney's career ascendancy, few have raised the possibility that Cobain was afraid he was losing her. "They both contributed to each other's music and they were competitive as well," says Charles Cross. Hole's advance from Geffen Records, more than \$2 million, Courtney says, was at the time one of the biggest in the history of the music business.

And yet "we could never find our money!" she said during a rant about how she and Cobain had allegedly been swindled. "I didn't know what EOM was! We had \$135,000 in our bank account. They said that if he would go do Lollapalooza he would make \$11 million."

Just before Cobain committed suicide he had been refusing to play the festival. "That's the last thing I ever said to Kurt Cobain, ever in my fucking life," Courtney said, "with [lawyers] holding up a sign saying we were gonna go broke..." She told him he should do Lollapalooza. Now she was crying inconsolably.

"Do you think Kurt would have killed himself if he had known he had \$54 million?" she demanded, quoting a figure based on the research of her Twitter Army.

### Where Did Our Love Go?

I think the theme of loss is truly one of the driving things in her life," said a friend of Courtney's. "When you look at the conspiracy, it's all part of this loss that has been part of her life since childhood. She's always trying to find out where it went—whether it's money or love."

Courtney's troubled history has been examined at length—most of all by Courtney. It's unusual to have a conversation with Courtney where she doesn't mention one of the outrages of her dysfunctional hippie upbringing: That her father, Hank Harrison, allegedly dosed her with LSD when she was four (Harrison denies this). That her mother, Linda Carroll, now a therapist, twice left her in the care of others, a family friend when Courtney was 9 and a former stepfather when she was 12. "My mother wants to kill me," Courtney says.

Courtney—born Courtney Michelle Harrison in San Francisco in 1964—wound up in the Oregon juvenile-detention system at 13. At 16, she became legally emancipated from her mother—actually a woman with a "sizeable inheritance" of her own, according to her memoir, *Her Mother's Daughter*—going on to become a stripper and then, improbably, a rock star.

"I swore I'd never be like my mother but I'm just the same," Courtney told me mournfully one day. "She threw it all away and I threw it all away."

And then there are Courtney and Frances.

"Look," Courtney said. "This is Frances's hope chest." We were in Courtney's bedroom, which was full of feminine, antique things.

Her bed was surrounded by stacks of papers having to do with "the fraud." At the end of the bed there was a sleek mahogany chest. She opened it.

"Her father gave her this." It was an old naked doll. "Fuck You Bitch" had been scrawled on its torso by Cobain. (His visual art shows his fascination with dolls, which he often used as humorous objects.)

"This is her diary," Courtney said, opening up a book.

"I don't want to read Frances's diary," I told her.

"I just want you to look at this one page."

It was titled "Things That Make Me Smile" and listed "my cat, my horse"—in middle school Frances was a champion rider—"Sailor Moon"—the Japanese cartoon—"New York in winter..."

Courtney looked crushed. "Why am I not on it?" she asked tearfully. "Why doesn't she put 'watching old movies with my mom'?"

Their relationship had a rocky start. The Los Angeles child-welfare authorities took Frances away from her mother and father shortly after her birth, pending an investigation into allegations of Courtney's drug use. What is not often mentioned is how Courtney had consulted with doctors as soon as she found out she was pregnant, and then gone to rehab. "There were no drugs in my urine, no drugs in her urine when she was born," she says, still angry at having had her baby taken away. Courtney's half-sister Jaimee looked after Frances during the court-ordered period. By all accounts, Kurt and Courtney were doting parents.

As I got to know Courtney, I heard more about Frances. When she wasn't talking about "the fraud," she was talking about her daughter. She was full of longing to speak to