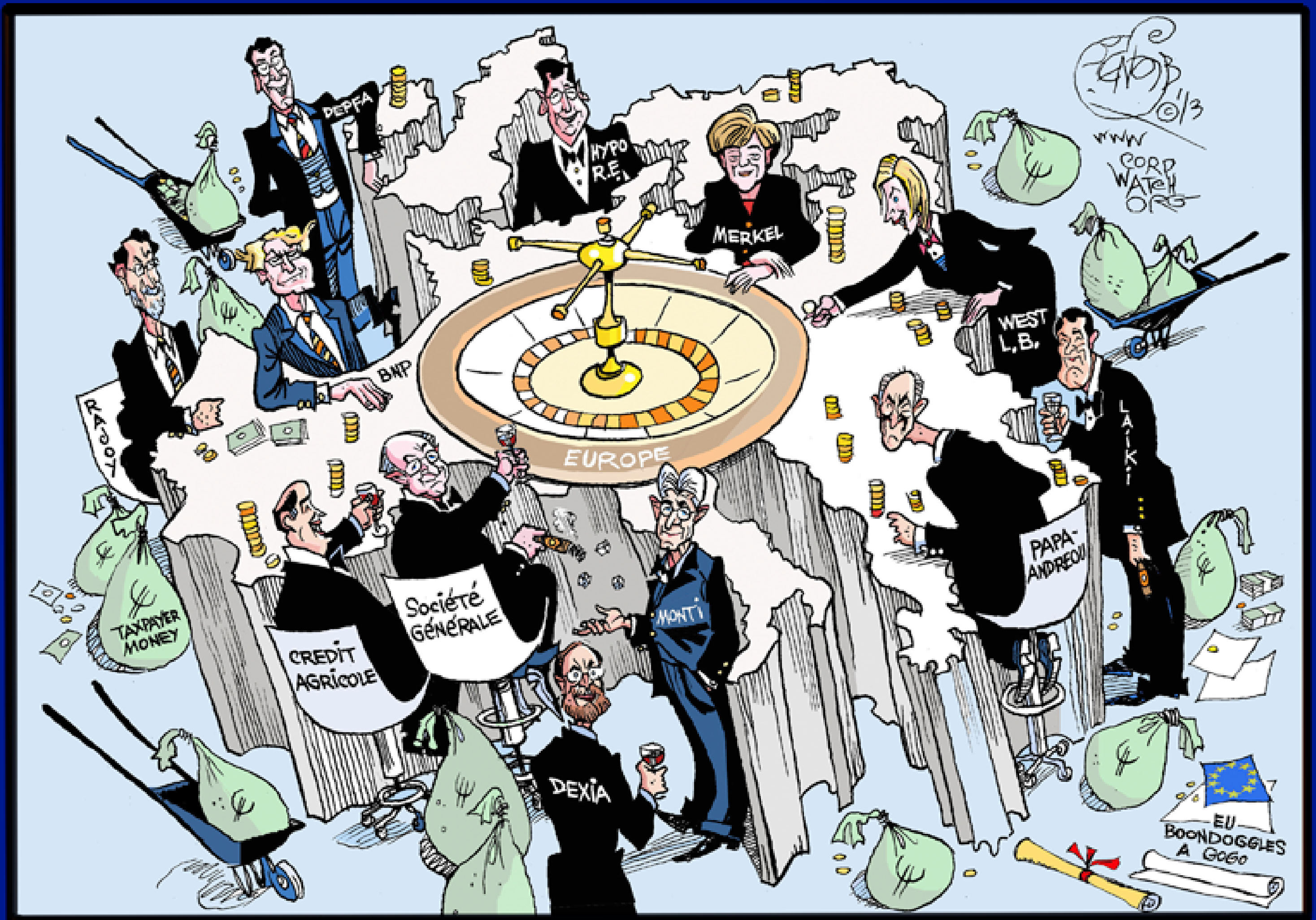

The EuroZone Profiteers

A CorpWatch Report, November 2013

CorpWatch
Holding Corporations Accountable
www.corpwatch.org

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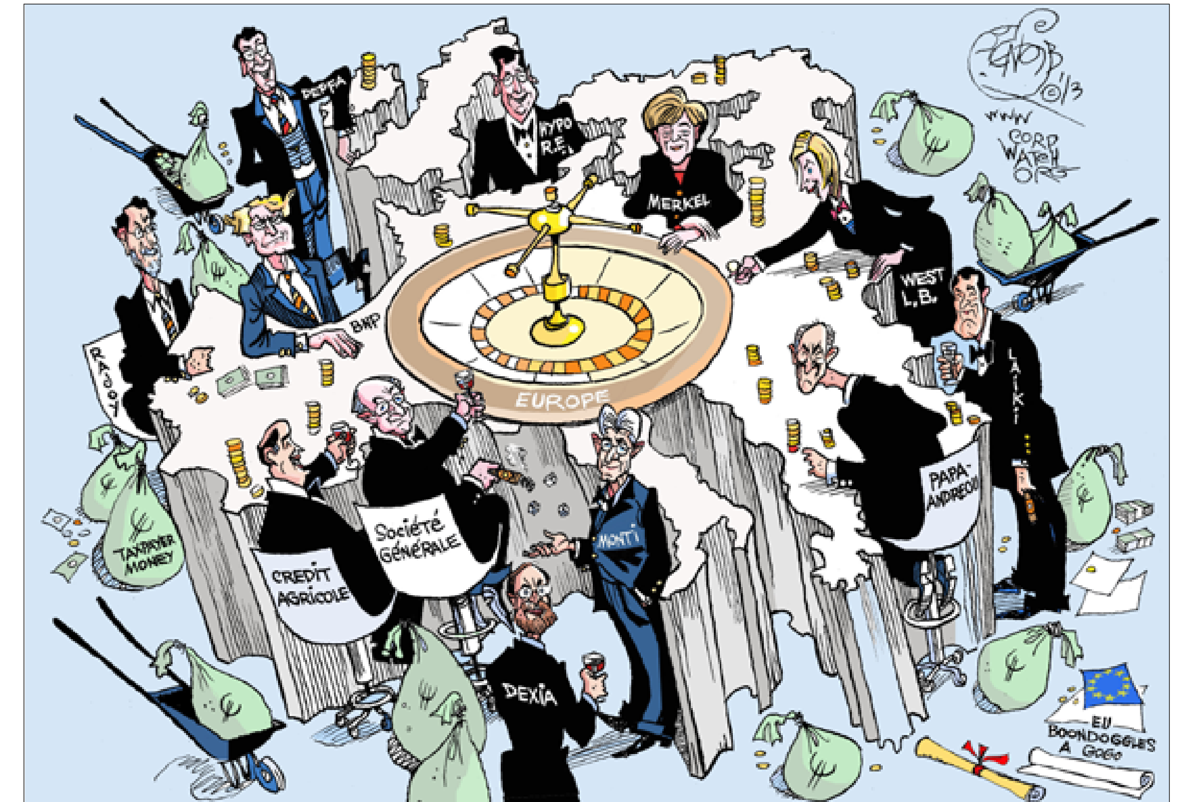
Introduction:

Welcome to the Casino



KHALIL BENDIB.

The impressive rise and sudden fall of the Greek, Irish and Spanish economies after they joined the EuroZone is often framed as a story of profligate governments and lazy citizens who spent too much and ended up deep in debt. The international community – notably the European Union (E.U.) – has been portrayed as a misguided group of bureaucrats who gave these foolish people billions to save them from their own recklessness and overspending.

But there's more to the story. There are lessons for everyone in understanding what happened in places like Spain and Ireland, for example, which have become the quintessential "canaries in the mineshaft" -- countries that did everything right, according to the economic "experts," and yet still ended up flat on their backs. Greece too, to some extent, followed the economic policies dictated by conventional wisdom. Now it turns out that the experts were wrong and their metrics for success were often measuring irrelevant data. Thus when an unforeseen $8 trillion housing bubble in the United States collapsed, it spread around the world like a tsunami.

There has been much debate among economists on how the creation of the euro without supportive infrastructure like a banking union caused this crisis in Europe. This report will add to that discussion by analyzing the role of six specific banks that joined this roller coaster ride by helping to finance and promote the

boom, only to be engulfed by it when the property bubble burst, first in the U.S. and then across the Atlantic.

In the end, these banks had to be rescued by their respective governments, damaging public balance sheets and resulting in indebted governments even in Ireland and Spain, which were running government surpluses with low debt before the EuroZone crisis. The banks that we chose represent a cross-section of institutions that helped trigger the crisis, although they are not necessarily the biggest banks nor the worst banks that took part in the boom and the bust. Our goal is to add to this dynamic debate by illustrating the public-private policy choices concerning the banking and finance sectors that, in total, nearly brought the EuroZone to the point of collapse.

For Europe, this economic crisis has been a wake-up call. The last few years has shown the limitations of an old economic model which, like in the U.S., relies on speculative asset bubbles which in turn leads to unsustainable private debt.

The Gamblers

Picture a fictitious EuroZone casino with a gambling table piled high with million-euro chips. Each chip represent a real mega-loan from a group of elite bankers in Belgium, France, Germany, the Netherlands, and the U.K. who, over the past dozen years during boom times, shoveled out money as fast as they could to borrowers in countries, including Greece, Ireland, and Spain.

Southern Europe is dotted with monuments to this frenzied lending. An airport in Castellón, in eastern Spain got a lavish loan in March 2006. It still has no planes, but it does feature a sculpture of Carlos Fabra, the regional politician who initiated the project.[1] A little digging shows the hand of Dexia Banco Sabadell, a Belgian-French bank that helped provide tens of millions of euros to build this architectural folly for which there still is no demand. And it wasn't the only foolish scheme. Regional banks and governments, which political parties in Spain historically had used to reward their local cronies with construction projects such as sports stadiums and "airports to nowhere," began to fail en masse when the bubble burst. It fell to the national government to take on these debts.

Or take the case of Georges Pauget, the CEO of Crédit Agricole in France, who bought up Emporiki Bank of Greece for €3.1 billion in cash in 2006. Over the next six years, Emporiki lost money year after year, blowing money on one foolish venture after another, until finally, Crédit Agricole sold it for €1 – not €1 billion or even €1 million – but a single euro to Alpha Bank in October 2012. Crédit Agricole's cumulative loss? €5.3 billion.[2]

Then there was Georg Funke, who ran Depfa, a German public mortgage bank. Depfa helped Athens get a star credit rating, raised €265 million for the Greek government railway, helped Portugal borrow €200 million to build up a water supplier, and gave €90 million to Spain to construct a privately operated road in Galicia. For a while, the middle class in Greece like the middle classes in Spain and Ireland, benefited from the infrastructure spending stimulus. When Depfa nearly collapsed in 2008, Funke was fired.[3]

These are just three examples of over-eager Belgian, French, and German banks that faced financial ruin after shoveling billions of euros for get-rich-quick schemes throughout Europe, investments in subprime mortgages in the U.S., as well as grandiose public schemes that were often abandoned half way through.

Today high stake rollers have moved into gamble on the debt created by the EuroZone crash. Dan Loeb of Third Point hedge fund scored $500 million gambling on Greek debt last December[4] while Achilles Risvas and Jason Manolopoulos run Dromeus Capital, another hedge fund that made millions this past January.[5] Meanwhile, Andreas Vgenopoulos of Laiki Bank in Cyprus lost €3 billion buying discount Greek bonds with savings entrusted to him by faraway Russians.[6] These hedge funds and their exotic investment instruments such as derivatives and credit default swaps are supposed to be a means to help manage the risk of global capitalism. Instead, they have helped build a house of cards. When the house wobbled, entire national economies collapsed.

While the casino is imaginary, the power, profits, and losses are real. This report attempts to illuminate the individuals and institutions in the runaway banking elite that fed the loans that helped weaken the wobbly foundation of the EuroZone, eventually ending in crisis. •

Who Owes Whom?

When Lehman Brothers, the New York investment bank, collapsed in September 2008, the global economy went into shock. The stock market plunged. U.S. and European banks froze lending to each other, afraid that they might be next. The New York Times called October the "wildest month in the history of Wall Street."[7] European leaders, sensing catastrophe, announced an unprecedented trillion-euro bailout to ensure that major banks in France, Germany, and the U.K. did not go under.

IMAGE COURTESY WORDLE

The impact of this crash on the smaller and poorer nations in Europe was not immediate, but unfolded in slow motion over the next few years. For example in May 2012 Bankia—Spain's fourth largest bank—asked the government for a €19 billion bailout,[8] while four Greek banks—Alpha Bank, Bank of Piraeus, Eurobank, and National Bank of Greece—needed a cash injection of €18 billion.[9]

As Greece's crisis raised fears of a default on its loans, European leaders feared a domino effect could engulf Ireland, Italy, Portugal and Spain, which in turn could threaten the stability of the euro as well as the entire post-World War II project to create a united Europe.

Politicians also suddenly realized that they had no mechanisms for debt pooling so that better-off member states could assist those hardest hit. So, the E.U. authorities and the International Monetary Fund (IMF) devised a variety of half-hearted back stop measures such as the European Financial Stability Fund and the European Stability Mechanism which made money available from major international lenders to make sure the payments on the loans to private banks would continue to be serviced. (As of June 2013, Greece has been promised €207 billion, Spain €100 billion, and Ireland an additional €85 billion.)[10]

Under this scheme, the stockholders of private banks were protected together with mom-and-pop depositors in places like Belgium, France and Germany who had entrusted their savings to their national banks, only to have those banks gamble their depositors' savings on risky loans in places like Greece, Ireland and Spain.

Irish and Spanish debt burdens ballooned practically overnight as governments were forced to take on debt to save the collapsing private sector. Bond spreads on government loans—which determine the cost for borrowing—doubled to levels not seen since the 1990s.

Had these countries controlled their own currency, they would have been able to print money and risk inflation to pay off their debt. Instead, they all were tied to the euro and had little control over monetary policy. So even the Socialist government in Spain felt it had no choice but to win back the trust of the bonds markets, in order to be able to continue to have access to international financing.

In return for bailing out the indebted governments, the European Central Bank (ECB), the IMF as well as international lenders and the bond markets, put immense pressure on the borrrowing governments to cut domestic

Euro sign outside European Central Bank in Frankfurt.

STEPHANIE JONES (SLOLEE)

in April 2013. "Our dreams are crushed," she adds. "They say that when you drown, your life flashes before your eyes. My sense is that in Greece, we are drowning on dry land."[13]

Politicians have easy explanations for Greece's descent into poverty. "As far as Athens is concerned, I … think about all those people who are trying to escape tax all the time. All these people in Greece who are trying to escape tax," Christian Lagarde, the French head of the IMF told the Guardian.[14]

There is no doubt that wealthy Greeks (like wealthy people everywhere) were not paying their fair share of taxes—or any taxes at all in many cases—or that some ordinary citizens avoided their tax burden. (Greece has had one of the lowest rates of tax collection of any developed country).

spending. Greece, Ireland and Spain (as well as Italy and Portugal) became locked into a vicious cycle of austerity.

All of these governments began laying off public employees, enacting salary cuts and freezes, a cost-of-living freeze for pensioners, higher retirement ages, increases in the value-added tax, and cuts in health care spending. Labor market reforms were passed, making it easier to hire and fire public employees.[11]

But instead of alleviating the financial crisis, the imposition of austerity measures reduced private consumption, aggregate demand and economic growth. The impacts have been disastrous: In Greece, for example, the number of children who arrived hungry at school skyrocketed. One student in ten has suffered from what public health professionals call "food insecurity," meaning they faced hunger or the risk of it, according to Prolepsis, a Greek public health non-profit. Prolepsis targeted 34 schools for food support where more than half of the 6400 families participating had experienced "medium to serious hunger."[12]

"All around me I hear kids saying: 'My parents don't have any money. We don't know what we are going to do,'" Evangelia Karakaxa, a high school student in Acharnes on the island of Crete told the New York Times

But few have investigated the role of the big European banks in the economic crisis in Greece, Ireland, Italy, Portugal and Spain. These banks pushed politicians and private investors to accumulate some of this debt, since the financial sector profits not only from interest on loans but from exorbitant fees paid to broker contracts and deals.

These projects did provide a stimulus in the short term that benefited average people and the middle class to some extent. But when the house of cards collapsed, it was ordinary citizens like shopkeepers, small entrepreneurs, and school children who were stuck holding the bag.

Today the financial industry has resumed many of their high-flying ways – indeed some banks are even bigger than they were before the crisis - while ordinary citizens are being forced to pay the price of the poor stewardship by bankers and bureaucrats that contributed greatly to the EuroZone crisis.

So who was pushing billions of euros in cheap loans that are now so difficult to pay back?

Bloomberg took a look at statistics from the Bank for International Settlements, and worked out that German banks loaned out a staggering $704 billion to Greece, Ireland, Italy, Portugal, and Spain before December 2009.[15] Two of Germany's largest private banks—Commerzbank and Deutsche Bank—loaned $201 billion to Greece, Ireland, Italy, Portugal, and Spain, according to numbers compiled by BusinessInsider.[16] And BNP Paribas and Crédit Agricole of France loaned $477 billion to Greece, Ireland, Italy, Portugal, and Spain.[17]

Some of this money is now being paid back to the careless lenders with the help of E.U. institutions. Much of the bailout money is in fact coming from Germany. In other words, the German government is using taxpayer money to prevent its own banks from collapsing. Those banks, in turn, are holding the deposits of many of these very same taxpayers, meaning that average depositors are having to pay a premium just to maintain the security of their own savings.

"The euro-zone crisis is often framed as a bailout that rich, responsible countries like Germany have extended to poor, irresponsible countries like Greece," wrote Ezra Klein in the Washington Post.[18] Not so, says Peter Böfinger, an economic advisor to the German government: The bailouts "are first and foremost not about the problem countries, but about our own banks, which hold high amounts of credit there," he told Der Spiegel.[19]

This conclusion is backed up by a study conducted by ATTAC Austria and published in July 2013. It showed that 77 percent of the €207 billion provided for the so-called "Greek bail-out" went to the financial sector and not to the people. "The goal of the political elites is not the rescue of the Greek population but the rescue of the financial sector," said Lisa Mittendrein of ATTAC in a press release. "They used hundreds of billions of public money to save banks and other financial players—and especially their owners—from the financial crisis they caused."[20]

The institutional lenders made it very clear that they were not forgiving most of the loans, though they did have to take some losses that amounted to 53.5 percent of Greece's debt to private lenders. But in a very real sense, the countries in crisis were receiving assistance simply to pay back their debts in order to convince markets that the Belgian, French and German banking sector would not collapse. The lack of confidence in the markets became apparent in 2008 when the euro plummeted against the dollar,[21] and as ratings agencies threatened to downgrade the lending countries' AAA rated bonds—causing borrowing costs to rise. (France was downgraded in January 2012.)[22]

In the next section, we look at a cross-section of the banks that made these loans, and examine why they suddenly poured money into Greece, Ireland, Italy, Portugal, and Spain. We'll start with three German banks from three different backgrounds, then look at two major French banks, and finally at a Belgian mega-bank.

From these six case studies, it will become clear that the European banking crisis was not just a series of unfortunate mistakes, but a result of the deliberate policies of politicians in Brussels, Paris, and Bonn who, in the late 1990s, went out of their way to encourage big banks in these countries to compete internationally.[23]

First, Germany and France—which had traditionally supported their banks' lending to local and regional businesses—withdrew state guarantees, and privatized their banking sectors.

Then, in 1997 the successful conclusion of the World Trade Organization's deal opened up trade in financial services,[24] and major European banks became aware that the big Anglo-American banks were snapping at their heels and that they needed to be more competitive.

These two crucial motivating factors coincided with the introduction of the euro in 1999-2002.[25] So these banks—all of which had solid credit ratings but little prospect of expanding at home—used their easy access to money to try to win new business by lending to the poorer countries at the periphery of the E.U. who suddenly were blessed with historically low interest rates and borrowing costs.

After struggling with high interest rates for decades as well as high unemployment, the poorest countries of the EuroZone jumped at the cheap and easy loans that came their way. But the sudden cash influx created an unsustainable economic bubble driven by speculative investment schemes in the borrowing countries. Today, they are paying dearly for that move and for the gamble by the bankers and politicians in search of quick profits. •

German Banking:

Overbanked and Parochial, or Small is Beautiful?

- **Where:** Germany
- **What happened:** It tried to consolidate small banks, withdrew state guarantees to regional banks, and privatized Depfa, a major public bank. These banks looked for profits in the EuroZone after the creation of the Euro by borrowing cheap money in Germany to lend to countries with previously double digit rates. Real estate banks also made risky loans during construction boom.
- **How Much:** $704 billion at risk in Greece, Ireland, Italy, Portugal and Spain.
- **Outcome:** It bailed out several banks and closed down others. About €646 billion was provided to bailout German banks. State now owns about 45 percent of banks.[26]

Outside the Frankfurt stock exchange stand two bronze statues: a bull and a bear. In the summer of 2005, a real (and much larger) elephant named Tembo was brought to pose for photographs beside these two symbols of the rollercoaster nature of financial markets. The public relations stunt was conducted by Eurohypo—a division of Commerzbank—to mark the tenth anniversary of a new kind of bond—the jumbo-Pfandbrief worth at least €1 billion.[27]

Tembo meets Bull and Bear at the Frankfurt Stock Exchange, May 2005.

The elephant was supposed to symbolize stability, longevity, and size—centuries-old hallmarks of German banking. But ironically, Eurohypo and Commerzbank would, unlike the stolid pachyderm, soon come to symbolize the massive size of the failure of the German banking system.

To understand this transition requires a little background into the somewhat unusual nature of German banking. While Anglo-American banking is dominated by many branches of a few major banks like Barclays

EUROPEAN PARLIAMENT

Chancellor Angela Merkel addresses the European Parliament.

or Citibank, Germany had 4,000 unique institutions in 1990 that comprised a three-pillar system of savings banks, co-operative banks, and private banks. The first two provide the bulk of the lending to the "mittelstand" (small- and medium-sized enterprises from households to niche family-owned companies), while the private banks serve major businesses.[28]

When the small savings banks needed more sophisticated services like hedging, they turned to 12 landesbanken (regional banks). These landesbank enjoyed state guarantees (known as "anstaltslast" and "gewährträger-haftung") that allowed them to borrow and lend at low rates.[29] Since they were publicly owned, they had no need to dabble in anything too risky, and could actually fulfill the elephant's stolid image.

Free-market thinkers had griped for years about the German system. Its three-pillar system of thousands of little banks, they argued, stifled competition and prevented non-German banks from competing for local customers in an open European market. Germany's bank lived modestly with a miniscule 1 percent profit, while Britain's four mega-banks, for example, boasted returns as high as 30 percent on equity.[30]

Free-market thinkers had griped for years about the German system. Its three-pillar system of thousands of little banks, they argued, stifled competition and prevented non-German banks from competing for local customers in an open European market.

In 1999, the *Economist* magazine declared that "Europe" (meaning specifically Germany and France) was "overbanked," and used the Bavarian town of Erlangen as an example: "Between them the big banks … have seven branches there. The local savings bank has 50 branches. Small wonder that Deutsche Bank, for example, has only 6 percent of German deposits. Contrast this with Lloyds TSB, which has a quarter of all current-account deposits in Britain." [31]

The *Economist* noted that some of the bigger banks such as Westdeutsche Landesbank (WestLB) and Commerzbank could become international players by diversifying into investment banking and other high-margin business in order to increase profits and expand.

Over the next decade, under pressure from E.U. bureaucrats including Mario Monti (the former competition commissioner who later became prime minister of Italy), the German government agreed to push some of these big banks to become more "market oriented."[32] The landesbanken lost their federal guarantees, and along with them, its high credit ratings and easy access to cheap funding. Pretty soon the landesbank, together with the major private banks, started to merge and consolidate, while taking greater risks such as investing in speculative real estate projects around the world in the hope of turning enough of a profit to beat their competition.[33]

Fast forward a decade to April 2009. Instead of becoming more efficient and profitable, the German banking system had racked up an astronomical €816 billion in troubled assets from unwise investments (notably in countries including Greece, Ireland, and Spain).[34] Three years later, WestLB collapsed completely as did Eurohypo—the hard-charging real estate subsidiary of Commerzbank that had paraded the elephant through the streets of Frankfurt.[35]

BASTIAN K. (BASI_16816)

By contrast, the 423 savings banks and 1,116 co-operative banks that did not speculate, survived and are still making small but decent profits.

"[German] lenders are parochial. That seemed antiquated once," wrote a chastened *Economist* in November 2012. "It now looks less stick-in-the-mud than it did. Two of the pillars [savings and cooperative banks] have come through the crisis with barely a scratch so far." [36]

Nor were the regional and private banks the only ones to take a major hit after the state forced them to compete in international markets.

Deutsche Pfandbriefbank (known as Depfa) was another massive casualty of this era of market competition. [37] It had been created as a public-sector mortgage bank to help the country rebuild after World War I—a time when few Germans had money to invest in private homes, and there was little tax income to finance major municipal projects.

From its origins in 1922 when it initially financed houses as well as multifamily residential units, to its heyday in the 1950s and 1960s when the bank began to finance government projects such as bridges and highways, Depfa's preferred status as a federal bank helped it raise money in capital markets.[38]

In 1992 Depfa was privatized to raise money for the state.[39] The bank started to look overseas for new business at just about the same time that Ireland was hoping to create an international financial center to attract new investment.[40]

A decade later, Depfa managers made a surprising and bold decision to move the headquarters to Dublin in 2002 to take advantage of tax breaks, and to escape German regulation that made it hard to make loans overseas to Japan or the United States.[41]

Some 30 offices were opened around the world with the goal of transforming Depfa into a major global financier for indebted governments in Brazil, Hong Kong, India, Spain, and the U.S.[42]

In 2007, another private German bank bought out Depfa, but by 2009 the German government had to nationalize the merged entity to save it from complete collapse.[43]

In the next section, we'll see why the changes in German banking regulations caused three of these titans of traditional German banking—Commerzbank and WestLB, as well as Depfa—to suddenly self-destruct after decades of serving the public. •

Westdeutsche Landesbank:
A Jumbo with Engines on Fire and Nowhere to Land

- **Westdeutsche Landesbank.** This regional bank traces its roots back to 1832 and had total assets worth €294 billion at its peak in 2005.
- **Where:** Düsseldorf. Germany.
- **What happened:** It speculated on complex financial transactions abroad in the U.K., Ireland, and other European nations after losing state guarantees. It lost €7.21 billion.
- **Outcome:** It closed down June 30, 2012 and had its assets placed a new bank: Portigon Financial Services.

Robin Saunders, a U.S.-born banker, was the toast of the U.K. financial media at the dawn of the 21st century. Newspapers, from the conservative *Daily Telegraph* to the left-wing *Guardian,* marveled at her audacious £961 million (€1.2 billion) bid for the Anglian Water Group.[44]

WestLB advertisment

They also reveled in gossip about the attractive blonde financier, fueled by extravagances such as her £400,000 (€500,000) birthday party in Florence for 180 friends, which included dinner at a historic palace (dress code "Italian medieval")[45] and her hobbies like hip-hop dance. She was nicknamed "Rockin Robin."[46]

Saunders was in charge of the Principal Finance Group and Asset Securitization division at WestLB, the biggest of the German landesbanken, which was partly owned by the state of North Rhine-Westphalia. Between her arrival in 1998 and her departure in 2003, the bank underwrote at least 30 transactions worth €22 billion.[47]

At first, getting the money was easy. With its state guarantees, WestLB was able to undercut other private banks like Deutsche Bank by a whole percentage point or more.[48] Saunders drew up complex transactions that allowed her to lend borrowers the capital she had raised in return for future income streams. Clients included Bernie Ecclestone's Formula One business, London's Wembley Stadium, and Whyte and Mackay, a well known Scottish whisky company.[49]

"She likes to dream up new ways of making the assets sweat, of using them as backing in return for an injection of capital," wrote an admiring reporter in the *London Evening Standard.* "[S]he reckoned, quite rightly, that at Goldman [Sachs] she could have sunk without trace. But at WestLB there was more chance of her star shining, and of being listened to."[50]

Such transactions were not unheard of at the giant German regional bank that had made loans to companies such as Enron and WorldCom in the 1990s and to countries including South Korea and Mexico. But when these deals went bad, the German government had always helped out.[51]

In 2002, WestLB was the first landesbank to be forced by the E.U. to give up its state guarantees.[52] But with no access to the retail banking market (controlled by the "sparkassen" or local savings banks), WestLB's access to quick and cheap money dried up.

Soon, Saunders' long-term loans started to unravel. WestLB posted a €1.7 billion-euro loss by the end of 2002.[53] Over the next decade, WestLB posted a profit only three years out of ten, and saw €1.13 billion euros in profits swallowed by €7.21 billion euros in losses.[54]

> *"She likes to dream up new ways of making the assets sweat, of using them as backing in return for an injection of capital."*

The first head to roll was Jürgen Sengera, WestLB's chairman, followed by Saunders in late 2003.[55] But even after her departure, the bank continued to make risky investments. For example, in 2007, the bank lost €600 million on speculative schemes like betting on the price difference between two kinds of Volkswagen shares.[56] In 2008, the bank declared a €1.6 billion loss, mostly from subprime mortgage investments in the U.S.[57]

By 2010, one German banker described WestLB as a "jumbo with the engines on fire and nowhere to land." The bank had toxic debts worth an eye-popping €77 billion.[58]

On June 29, 2012, WestLB was closed down. "Its demise is a lesson in hubris to its peers," wrote a *Bloomberg* reporter. "The closure marks the end of a tumult that crossed collateralized debt, international real estate and U.S. subprime markets, and WestLB's attempt to conquer the investment banking industry."[59] •

WESTLB 2011 ANNUAL REPORT

Depfa and Hypo Real Estate:
One-Eyed Man Becomes King in the Land of the Blind

- **Deutsche Pfandbriefbank.** Founded 1922 as a public bank to finance small-scale residential construction, its total assets were worth €218 billion at its peak in 2007.
- **Where:** First based in Berlin, Germany; headquarters moved to Dublin in 2002.
- **What happened:** Privatized in 1992. It borrowed in short-term markets to lend for risky private- and public-sector projects in Greece, Ireland, and Spain. Depfa was bought up by Hypo Real Estate, which eventually needed a €10 billion bailout and €142 billion in state guarantees.
- **Outcome:** It was forced to borrow up to $28.5 billion from the U.S. Federal Reserve in November 2008. The German government renationalized it via a series of bailouts. It has closed to new business, and must be sold off by 2015.

Gerhard Bruckermann, the son of a manager of the credit department of a local bank, was appointed CEO of Depfa in 2002. He quickly moved the headquarters to Dublin to take advantage of the low tax rates, although he personally divided his time between London and a Spanish farm where he grew rare medicinal plants.[60]

Greenpeace protest outside Hypo Real Estate offices in Frankfurt, March 2009. The sign reads: "If the world were a bank, you would have already saved it."

KELLERABTEIL

"Our corporate governance has changed from the German model to the Anglo-American model," Bruckermann boasted to Institutional Investor in 2003.[61] Depfa made long-term loans to governments using money it borrowed from other banks at cheaper, short-term rates, and then pocketed the difference. Depfa would then refinance the loans.

Of course, this model only worked as long as there was enough money around to continue to borrow at low interest rates. Depfa also sold complicated collateralized debt obligations (CDO) and German bonds that were backed by loans or securities issued by the public sector.[62]

It wasn't hard to find clients. At the time, many cities and government agencies that were strapped for cash and plagued by debt, were eager to borrow from unconventional—but established and apparently trustworthy-financiers like Depfa. According to *Reuters*, between 2005 and 2008, sales of CDOs and other complex financial products increased 270 percent over the previous four years.[63]

For example, according to its 2007 annual report, Depfa helped the city of Jerez, Spain, refinance its debt; provided credit advice to Athens; financed a conference center in Dublin and a toll road between Tijuana, Mexico, and San Diego, California; and invested retirement funds for teachers in Wisconsin.[64]

"Selling these products to municipalities was pretty widespread," Janet Tavakoli, a finance industry consultant in Chicago, told the *New York Times.* "They tend to be less sophisticated. So bankers sell them products stuffed with junk."[65]

Bruckermann wasn't even embarrassed about selling these risky products to non-commercial clients. "With our efforts, we are like the one-eyed man who becomes king in the land of the blind," he once boasted to a trade publication quoted in the *New York Times.*[66]

At exactly the same time HypoVereinsbank, a German private bank now known as the HVB Group, also decided to create an independent entity to manage its commercial real estate financing operations. Hypo Real Estate, set up in 2003, quickly became the second largest public finance bank and mortgage lender in Germany, issuing loans and selling bonds and CDOs to municipal governments worldwide.[67]

All told, during the boom years before the financial collapse, Hypo handed out more than €200 billion to finance similarly risky real estate developments worldwide—some of which were linked to the U.S. subprime mortgage crisis.

In 2007, the international and U.S. economies had already begun to stagnate. Both Hypo and Depfa, whose profits had grown through funding large-scale projects such as luxury shopping centers, high-end business complexes, and extravagant tract home developments, became some of the first victims of the global recession. Depfa's model of borrowing and lending made it almost wholly dependent on short-term credit provided by other banks.

One year before the U.S.-based investment bank Lehman Brothers collapsed in 2008, Hypo, led by chief executive, Georg Funke, bought Depfa for €5.7 billion.[68] Depfa CEO Bruckermann pocketed more than €100 million as commission from the deal, and then left the bank abruptly, effectively dropping out of sight.[69]

All told, during the boom years before the financial collapse, Hypo handed out more than €200 billion to finance similarly risky real estate developments worldwide —some of which were linked to the U.S. subprime mortgage crisis.[70]

After Lehman Brothers went bankrupt in September 2008, banks stopped extending short-term credit to each other.[71] Suddenly, Depfa—now a wholly owned subsidiary of Dublin-based Hypo—could no longer continue borrowing at the rate necessary to sustain its operations and pay its own increasing debts. Additionally, Hypo had lent some €80 billion to Greece, Ireland, Italy, Portugal, and Spain, where the real estate markets were plummeting.[72]

The merged bank faced imminent bankruptcy, and threatened to drag down the rest of the economy with it. Within weeks, the German government agreed to an initial bailout of Hypo, with state guarantees and loans worth €35 billion.[73]

Still, Hypo tried to keep up appearances. In November 2008, Funke denied that it had been a mistake for Hypo to buy Depfa. "Since its takeover in October 2007, Depfa Bank has become an essential part of Hypo Real Estate's business and success," he stated in a press release.[74]

In December 2008, Funke was fired.

That same month, investigators from the Munich public prosecutor's office raided multiple Hypo offices and properties associated with Hypo's former board members. The criminal investigation against Hypo was brought by a shareholder interest group. The prosecutor's search warrant alleged "false statements," "market manipulation," and "breach of trust" by current and former members of Hypo's board. Prosecutors said they believed that Hypo's directors had concealed important information from the public for more than a year, and that the board had not restructured at the necessary time.[75]

BaFin, Germany's banking regulator, also investigated the company for insider trading and other violations. Hypo executives maintained that the board hadn't known the true state of affairs.[76]

Matters did not improve for Hypo the following year. After continued losses, the bank was nationalized by the German government in October 2009, and its remaining shareholders were forced out.[77]

That same year, Funke sold his Munich mansion, and took up residence on the Spanish island of Mallorca.[78] He sued Hypo for firing him over the bank's bailout, demanding salary payments for part of 2009, as well as pension pay. He won a preliminary ruling in October 2010, and the Munich Regional Court awarded him €150,000—the equivalent of two months' salary. Hypo said it would continue legal action to prove that the bank had fired Funke with good cause.[79] Ultimately Hypo Real Estate's misadventures would cost the German government €10 billion in bailout funds and €142 billion in state guarantees. •

Commerzbank:
Property Lending Can Be A Mug's Game

- **Eurohypo/Commerzbank.** Founded in 1870, it had total assets worth €292 billion at its peak in 2008.
- **Where:** Frankfurt, Germany.
- **What happened:** It merged its real estate division with those of Dresdner Bank and Deutsche Bank in 2001 into a new entity, Eurohypo, which loaned billions to real estate projects in Spain and elsewhere.
- **Outcome:** Commerzbank was given a €18 billion bailout in March 2012. Three months later it began winding down Eurohypo by selling off assets.

When Ukranian billionaire Rinat Akhmetov paid £136 million (€170 million) in April 2011 for a penthouse at the One Hyde Park in London, it made headlines around the world as the most expensive apartment sale in history.[80]

The opening of the real estate development at One Hyde Park was a crowning moment for Eurohypo, the German property lender that had provided a £1.15 billion (€1.44 billion) loan in October 2007 to buy and refurbish the building opposite the Knightsbridge underground station.[81] Soon after the building opened for sale, Eurohypo's loan was repaid in full.[82]

Eurohypo offices in Berlin.

WILL SCHRIMSHAW (POPORTIS)

Eurohypo was created in late 2001 when Commerzbank, Dresdner Bank, and Deutsche Bank—three of Germany's biggest private banks—merged their real estate portfolios. The move was meant to salvage ventures that had turned toxic because of reckless expansion into East Germany after the 1989 fall of the Berlin Wall.[83]

"[T]hey are creating this leaner, bigger bank not to attack the mortgage and public-sector lending market afresh, but to retreat from it. The spoils there are thin," wrote the *Economist* in November 2001 when the plan was first announced. "[P]roperty lending can be a mug's game."[84]

The new entity—which would eventually control a €292 billion portfolio—instantly became the largest issuer of *Pfandbriefe*—bonds backed by mortgages and loans to the public sector.[85] Over the next few years, Eurohypo plunged into making mega-loans to the rest of Europe, as well as to the U.S.

"Eurohypo and other German mortgage banks are really playing at the top level," Eurohypo CEO Bernd

Knobloch boasted to the *Financial Times* in 2005. "Everyone complains about the shrinking importance of Germany's big banks in the world. But in real estate banking, the reverse is true. … Actually we're the biggest in the world, because there are no other companies like us."[86]

In 2005, Commerzbank, confident it could make a killing, bought out the portfolios of Dresdner Bank and Deutsche Bank. "Now, it looks like a money-spinner," Allan Saunderson, editor of the newsletter *Property Finance Europe,* told the *New York Times.* The *Times* dubbed the move a "stunning turnaround" from the days of "catastrophic real estate businesses, including billions of euros in bad loans."[87]

"The comeback is remarkable," the *Financial Times* enthused at the time, singling out three banks—Eurohypo, Hypo Real Estate, and Depfa. "These businesses were offloaded by their parent banks because they were seen as risky and burdensome. They threw money at customers in the 1990s and were left holding billions of euros of bad debts."[88]

Just a couple of years later, the touted remarkable and stunning revival of German real estate lenders turned out to be a mirage.

Just a couple of years later, the touted remarkable and stunning revival of German real estate lenders turned out to be a mirage. In Spain, for example, Eurohypo had made multibillion-euro loans to Inmobiliaria Colonial, a property company with offices for rent in Barcelona, Madrid, and Paris.[89] In 2008, Inmobiliaria Colonial was forced to seek outside investment to stave off collapse.[90] Eurohypo also backed failed commercial developments such as the €400 million Project Copernicus, the €370 million Project Sol, and the €110 million Hilton Hotel in Valencia—all of which had to be put up for sale at deep discounts.[91]

In 2011, Commerzbank announced that it had some €17 billion at risk in banking and real estate ventures in Greece, Spain, and other southern European countries, as well as another €13 billion in sovereign debt from the same countries, mostly from Eurohypo.[92]

In March 2012, exactly a decade after Eurohypo was created, and a year after the One Hyde Park sale, Commerzbank asked the European Commission for permission to wind down all Eurohypo operations, and sell off whatever it could to avoid bringing down the rest of the bank.[93]

"Against the background of the ongoing financial and sovereign debt crisis, an end to which is not foreseeable, and of the uncertain regulatory environment, we are subjecting all the business areas to a rigorous review," said Martin Blessing, chairman of Commerzbank in a June 2012 press release. "The Board of Managing Directors has today, therefore, decided to wind up the business areas Commercial Real Estate and Ship Finance in the course of time."[94] •

French Banking:

Less State = Less Happiness

- **Where:** France.
- **What happened:** It privatized all banks that had been nationalized after World War II. Banks looked for profits in the EuroZone after the creation of the euro by borrowing cheap money in France to lend to countries with previously double digit rates.
- **How Much:** $477 billion at risk in Greece, Ireland, Italy, Portugal and Spain.
- **Outcome:** It had to provide €370 billion in bailout measures to major banks in 2008.

For almost four decades after the Second World War, French banking was a rather sleepy business as a result of two waves of nationalization: first by General Charles de Gaulle in 1945 and then by President Pierre Mauroy in 1982.[95] The main task of the big banks, the Socialist governments decided, was to collect savings, and help the government issue bonds. Just as in Germany, they enjoyed state protection, and were easily able to raise money for themselves.

Things began to change in 1987 when Prime Minister Jacques Chirac, himself the son of a banker, began a process of privatizing the banks. He later explained that he believed the industry needed to "shoulder its responsibilities to the business community."[96]

Banque de France offices in Paris.

DOUG (CARIBB)

Société Générale, an established French institution founded in 1864, was one of the first to return to the private sector in 1987.[97] The following year saw the privatization of Crédit Agricole—majority owned by 39 state-organized regional cooperative banks that got its start providing loans to French farmers in the 19th century. It emerged as a powerhouse with 9,100 branches and 27 million customers, and started to look for opportunities.[98]

Other newly private French banks also started to merge and expand. BNP Paribas was created by combining several different kinds of banks: Banque de Paris et des Pays-Bas (an investment bank), Banque Nationale pour le Commerce et L'Industrie (a commercial bank), and Banque Nationale de Paris (a retail bank). Each

emerged from nationalization in the Chirac years, and then eventually came together as one bank in May 2000.[99]

Today BNP Paribas, Société Générale, and Crédit Agricole are the three biggest banks in France (in that order).[100] In contrast to the dominant Anglo-American banking model (which required banks to separate retail and investment banking until fairly recently), they embrace "universal banking"—with retail, commercial, and investment banking under one roof.[101]

PASCAL (PASUKARU76)

Société Générale started looking for acquisitions outside France in the late 1990s. Under CEO Daniel Bouton, it first bought banks in Bulgaria, Romania, Slovenia, and then, in 2004, it bought the General Bank of Greece.[102] That same year Baudouin Prot, CEO of BNP Paribas, announced that he had more than €5 billion to spend on takeovers in Europe and the U.S.[103] A year and a half later, Georges Pauget, newly appointed CEO of Credit Agricole, followed suit with a similar announcement, and quickly ploughed €9 billion in 2006 alone into buying up banks in Greece, Italy, Spain, and elsewhere.[104]

By the end of the decade, these investments had gone sour, and French banks were mired in bad debt. In October 2008, the government of Nicolas Sarkozy stepped in to ensure that the banks did not collapse completely and endanger the rest of France. It put up a €370 billion state guarantee to support the banking sector.

"We are in a changed era," explained Rene Ricol, the credit ombudsman who was put in charge of the bailout money. "Those who thought that less state was needed for more happiness got it wrong. We need the state."[105] •

Société Générale:
Arrived with A Swagger, Brought Down by A Gamble

- **Société Générale.** Founded in 1864, it was nationalized in 1945 and had assets worth €1.53 trillion in 2011.
- **Where:** Paris, France.
- **What happened:** After privatizing in 1987, it expanded into derivatives, and bought banks in Central and Southern Europe. It lost over €1 billion on Geniki bank in Greece and another €4.9 billion in derivative trading.
- **Outcome:** It took €3.4 billion in bailout funds from the French government in 2008, and sold Geniki in October 2012 to Piraeus bank for €1 million.

Daniel Bouton, an old school French banker, took over as CEO of Société Générale in 1993 after an illustrious career in the Inspection Générale des Finances. "Mr. Bouton arrived at SocGen with a swagger," wrote Adam Jones in the *Financial Times*. "The French like to call it entering "par la grande porte," or "through the main door."[106]

"Golf and opera are among his passions; he is said to have an encyclopedic knowledge of Burgundy [wines] and owns a highly regarded cellar of grands crus," wrote James Stewart in the *New Yorker* magazine. "He is a member of what may be France's most exclusive group, the secretive Club des Cents, which meets weekly to savor haute cuisine and fine wines."[107]

ROMAIN (ROAMINEPA)

Société Générale Headquarters, Paris.

Under Bouton, Société Générale rose to dizzying heights by building up an equity derivatives business with a staff of 12,000 working in 45 countries.[108] So when the news broke in January 2008 that a 31-year-old trader had secretly bet €50 billion, and stood to lose the bank almost €5 billion, Bouton was very, very angry. He called Jerome Kerviel, the unfortunate trader, a "financial terrorist."[109]

Investigators would later prove that Kerviel—who lived in a one-bedroom apartment, and did not even own a car—had not taken a penny from the bank, and that had he won

Parody of poster for French film: *Bank Error in Your Favor.*

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his bet (as he often had in the past), he would have been given a generous bonus.[110]

Unable to take "repeated attacks against me personally" for the huge losses caused by Kerviel, Bouton resigned as CEO a few months later, and then as chairman the following year.[111] The French media took delight in his fall, pointing out the class differences between him and Kerviel. Bouton had studied at all the right schools and knew all the right people while Kerviel was the son of a blacksmith from rural Brittany.[112]

Yet Bouton was just as guilty of spearheading another strategy that consistently lost money at the billion-euro scale for Société Générale: betting on Greek bonds and banks. Like the derivative betting business that he built by hiring traders such as Kerviel, Bouton attempted to profit from countries like Greece by spending heavily to impose his own brand of French banking management.

Initially, Bouton bought up small Central European banks.[113] But in 2004, he sent one of his trusted lieutenants, Jacques Tournebize, on a shopping mission to Athens.[114] Société Générale owned some shares in the General Bank of Greece, and Tournebize arranged to buy a significant minority stake from the Greek Army Pension Fund, and renamed the bank Geniki.[115]

As part of an ambitious expansion plan, Société Générale establish a network in the region, and Tournebize moved to Athens with a team of more than a dozen senior managers. "The Balkans are not very far," Tournebize told *La Tribune,* a French newspaper, in April 2006. "They constitute a natural opening for the Greek markets, and Greece wants to play its role in the banking network of the region."[116]

This regional fantasy was soon dashed. By 2007, Société Générale was forced to admit that the Greek purchase was doing badly.[117] That year Geniki posted relatively modest losses of €43.6 million, followed by another €37.5 million in losses in 2008.[118] Then in 2009, Geniki lost €109.5 million.[119] Finally came the crash: In 2010 Geniki lost €411 million, and in 2011 it lost €795.6 million euros.[120]

Until the bitter end, Société Générale tried to promote the idea that its investments in Greece were sound. **"Much silly talk on Greece,"** wrote the bank in an analytical statement issued Dec. 8, 2009. "Of course anything is possible. Pigs can fly and Armageddon could be for tomorrow. Just silly talk." [121] (Bold in original.)

Bouton was the first French banker to buy a major Greek bank, but not the only one to make this mistake. A few miles from Société Générale's gleaming skyscraper offices in the western suburbs of Paris, Georges Pauget worked out of the more modest offices of Crédit Agricole in Montparnasse. A former paratrooper with none of Bouton's elite education, Pauget fell into the very same trap. •

Crédit Agricole:
Arrived with A Swagger, Brought Down by A Gamble

- **Crédit Agricole.** Founded in 1894. It is majority owned by 39 state-organized regional cooperative banks and had assets worth €2.43 trillion in 2011.
- **Where:** Paris, France.
- **What happened:** It privatized in 1988, and spent heavily buying banks in Central and Southern Europe. It lost €5.3 billion on Emporiki bank in Greece.
- **Outcome:** It took €3 billion in bailout funds from French government in 2008, and sold Emporiki in October 2012 to Alpha bank for €1.

Pauget was appointed CEO of Crédit Agricole in late 2005. Just before Christmas, he met with a reporter from the *Financial Times* in the lounge of the Plaza Athénée luxury hotel in Paris to talk about the bank's ambitious new strategic plan to invest outside the country.

Protest outside Emporiki bank in Komotini, Greece, in 2009.

JOANNA PIAZZA DEL POPOLO

"We are not just in France. That is not a real view of our position," Pauget told the reporter, and he was "ready to forget the cautious lessons about banking deals" that he once taught as an economics professor—if the right opportunity came along.[122]

Pauget spoke of the €5 billion he was prepared to spend, noting that he no longer considered investment banking a risky, peripheral activity, but an essential element of success.

"We know that we can expect to do acquisitions in countries where we know people," he confidently told *Banker* magazine two months later.[123]

In June 2006, Pauget pounced on Emporiki Bank of Greece, offering €3.1 billion in cash to take it over.[124] A little more than two years after Bouton had bought Geniki, Pauget's move was still considered a bold move given that Emporiki was the least profitable of Greek banks at the time. But Emporiki appeared to have potential as the fourth largest residential mortgage provider and the fifth largest consumer credit provider with about 10 percent of the Greek market share. "People in Greece have an average of 2.5 banking products per person, so there is a lot of opportunity," the French bank said in a press release at the time. "In France the average is seven to nine products per person."[125]

And like Tournebize, Pauget believed that Greece was a gateway to the region. "One can no more understand the vigor and the potential of the Greek economy

simply in terms of its 10 million citizens; instead, one must look at it as being inseparable from the broader region's economies," he was quoted saying in 2006.[126]

Greece's biggest foreign investment, the Emporiki sale sparked a strike among Greek employees worried that the new owners would fire many of them. Meanwhile, experts raised serious doubts about the purchase. "The price paid is quite high," said Pierre Flabbee, an analyst at Landsbanki in Paris, told *Forbes* at the time.[127]

The Greek finance ministry waved it through.

In the heady years from 2005 to 2007, most other large banks were buying, merging, and expanding as quickly as possible. Going with the trend, Pauget bought up other banks—including Egyptian American Bank in Cairo and Banca Intesa Sanpaolo in Italy—spending almost twice as much as he initially suggested (€9 billion) in 2006 alone.[128] He even considered buying Alliance & Lester in the U.K. at the vastly inflated price of €7 billion. Given that it was valued at £1.33 billion (€1.64 billion) just two years later, the purchase would have been a complete disaster.[129]

By the time it sold the bank for €1 in October 2012, Crédit Agricole had lost €5.3 billion on Emporiki.

In 2007, Pauget arranged to buy an additional 15 percent share of Bankinter—Spain's sixth largest bank at the time. The sale made Crédit Agricole one of Bankinter's most significan minority owners.[130]

Again, commentators expressed surprise. "With Bankinter, Crédit Agricole has made a good choice, but the price they are paying seems steep," Pierre Flabbee, analyst at Landesbanki Kepler told *Forbes*.[131]

Crédit Agricole was growing at breakneck speed, expanding its investment banking operations, and opening offices in Eastern Europe, East and South Asia, the Middle East, North Africa, and the U.S. It sold CDOs and other debt instruments, including mortgage-backed securities.[132]

Financial analysts from Morningstar would later refer to Pauget's spree as "empire building," but at the time, he was seen as able "to make tough decisions … to steer the bank through troubled waters and the mettle to handle the pressure at the top," according to *European CEO* magazine.[133]

A number of these investments went sour quickly. Emporiki made a decent profit in 2007.[134] But every subsequent year Emporiki continued to lose heavily. In 2009, Emporiki took another €485 million impairment provision. By the time it sold the bank for €1 in October 2012, Crédit Agricole had lost €5.3 billion on Emporiki. Crédit Agricole's investments in the U.S. real estate market were also catastrophic.[135]

After the crisis hit, Pauget eventually succumbed to an insurrection inside the bank, and resigned in 2010. But not before he wrote a book to defend his role. In *Should We Burn the Bankers?*—he blamed regulators and central banks for the global credit meltdown. It was quickly followed by a second book, *The Post-Crisis Bank.* [136]

Despite Pauget's efforts to redeem himself through writing, his legacy seems fixed in failure. "Crédit Agricole SA has destroyed more shareholder value through international expansion than any bank in Europe," one London-based analyst speaking on condition of anonymity told *Reuters* in December 2012.[137] •

Dexia:
Using Public Funds to Support a Casino

- **Dexia.** Founded in 1996. It traces its roots back to Crédit Communal de Belgique in 1860 and Crédit Local de France in 1816. It had a balance sheet of €650 billion at its peak in 2008.
- **Where:** Brussels, Belgium.
- **What happened:** It borrowed heavily in short-term markets to lend to municipal authorities all over Europe including Greece and Spain. It guaranteed municipal transactions in the U.S.
- **Outcome:** It wrote down €3.65 billion in subprime mortgage losses, and was forced to borrow up to $37 billion from U.S. Federal Reserve in January 2009. Nationalized in October 2011.

In the mid-1990s, French branding expert Pierre Bessis—who specializes in naming products, from cars to perfumes—was hired by Crédit Communal de Belgique and Crédit Local de France. The two banks were planning a merger and wanted help creating a new identity. Bessis came up with the name Dexia, which he claimed evoked a "mix of strength and femininity and could be the name of an ancient goddess."[138]

Dexia advertisement: "More insight into your future through Dexia."

DUVAL GUILLAUME

For Crédit Communal de Belgique (founded in1860) and Crédit Local de France, a division of the Caisse des Dépôts et Consignations (established in 1816), the new name marked a new mission. It was intended as a symbolic way "to get away from their rather administrative names that refer to their core businesses" of making loans to build schools and finance public transport, according to Bessis.

Yet the change was more than symbolic. The founders of Dexia—officially launched in 1996—had an ambitious plan to expand the centuries-old function of the original banks. The new entity would provide cheap credit to municipalities across Europe once the euro was launched, and even beyond.

In Austria, Dexia upped its stake to 49 percent in Kommunalkredit—a financier of local municipal projects.[139] In Spain, Dexia set up a joint venture with Banco Sabadell of Barcelona, in which it held a 60 percent majority share.[140] Dexia also took a 40 percent stake in Crediop, a major Italian financier of local projects, and majority control of Banque Internationale à Luxembourg, that country's oldest bank.[141] In the U.S., Dexia bought Financial Security Assurance, which provided bond insurance to municipalities.[142]

The man behind this plan was Pierre Richard, who became president of the Dexia's board of directors. He was

Dexia ATM in Antwerp

HARRY_NL

aided by a young Belgian lawyer, Axel Miller, who joined the company in 2001, and became its CEO in 2006.[143]

Dexia quickly became a major player around Europe, giving small cities and towns loans typically ranging from €5 to €50 million. These were not huge amounts for a bank that would eventually have a portfolio of some €650 billion, but they represented sizeable debts for many of the borrowers.[144]

For example, via Kommunalkredit, Dexia loaned €25 million to Yiannis Kazakos, the mayor of Zografou, a suburb of Athens, to buy land to build a shopping mall.[145] It made similar loans to other Greek municipal authorities including Acharnon, Melisia, Metamorfosis, Nea Ionia, Serres, and Volos.[146] In France, Dexia extended €10 billion to some 100 local councils.[147] The loans sounded like great deals to the local authorities, but in reality were tied to highly complex foreign currency exchange and variable interest rates that the small municipal agencies rarely had the expertise to assess. One classic case was the town of Saint-Etienne in central France that took out a loan linked to the "difference between the 10-year British pound constant-maturity-swap and the 6-month Japanese benchmark."[148]

Across the Atlantic, Dexia guaranteed municipal borrowings from the "Texas Veterans Land Board in Austin [to] the Los Angeles County Metropolitan Transportation Authority," according to *Bloomberg*.[149]

Like Depfa in Germany, Dexia financed these venture by borrowing heavily in short-term markets. It also invested in risky instruments such as unsecured Lehman Brothers bonds, mortgage-backed securities issued by JP Morgan, and sovereign Greek and Spanish debt.[150]

All this started to come apart when Lehman collapsed in September 2008. After Dexia was forced to write down €3.65 billion in subprime mortgage losses, Belgium, France, and Luxembourg came to its rescue with a €6.4 billion bailout.[151] Pierre Richard and Axel Miller were sacked.[152]

In October 2011—just three months after passing the stress test with flying colors—the Belgian and French governments were forced to provide Dexia with €90 billion in guarantees to prevent it from going bankrupt.

Dexia was also in severe trouble over the credit protection it had offered on interest rate swaps for municipal buyers in the U.S. Starting in September 2008, Dexia borrowed an average of $12.3 billion a day in short-term loans from the U.S. Federal Reserve to ensure it could cover any claims. By January 2009 peak borrowings reached $37 billion.[153] (Depfa—the German bank—was in similar trouble; it drew short-term U.S. government loans worth as much as $28.5 billion).[154]

In July 2011 the European Banking Authority rated Dexia as the 12th safest bank in the E.U. after determining that it had a core Tier One capital ratio of 10.3 percent (the ratio of assets such as core equity capital measured against total risk-weighted assets).[155]

But despite having enough guaranteed assets to pass the stress tests, Dexia was still having problems with cash flow because the short-term money market had essentially shut down. And because it was suddenly paying more to borrow than to lend, its long-term loans to municipalities became unprofitable.

In 2011 it became clear the Greek creditors were not going to get their money back which exacerbated Dexia's problems. Dexia announced that it had €3.4 billion in Greek government debt alone.[156] Added to that, analysts calculated that it had another €17.5 billion in Italian, Portugese, and Spanish debt.[157] As bankers and politicians negotiated to write down the value of Greek bonds by 53 percent, Dexia reached the end of its rope.

In October 2011—just three months after passing the stress test with flying colors—the Belgian and French governments were forced to provide Dexia with €90 billion in guarantees to prevent it from going bankrupt.[158] Just 15 years after its creation, the bank was nationalized, and the governments began to look at ways to sell off whatever they could.

Some experts condemned the bailout. "This is like using public funds to support your local casino," Walker Todd, a former official at the U.S. Federal Reserve Bank of Cleveland, told the *New York Times.* "It is difficult to see how this is good for society in the long run."[159] •

Lending Frenzy

Mario Monti, former E.U. Competition Commissioner (left).

PRESIDENT OF THE EUROPEAN COUNCIL

The move by Greece, Spain, and Ireland to become eager customers of the Belgian, French, and German banks occurred within a continent-wide context. After the launch of the euro in 1999, European bureaucrats were talking up the planned "European Single Market in Financial Services" by championing the idea of banks competing against each other across the continent, regardless of national origin. They were eager for the staid old European banks to compete with the behemoth U.S. investment banks. Ever since the 1997 World Trade Organization negotiations on financial services began opening up Europe's banking, insurance, securities and financial information markets, U.S. firms were increasingly encroaching on the Europeans' territory.[160]

In October 1997 E.U. Competition Commissioner Mario Monti gave a speech to the Institute for International Monetary Affairs. "Sometimes it is said that competition is not to the benefit of all: It can favor larger firms, but hurt smaller businesses. I do not share this view," Monti said. "Naturally, competition will reward greater efficiency. It will put pressure on less-performing companies and on sectors already suffering from structural problems. It may require a restructuring of certain firms and industries, also to be achieved via mergers and acquisitions. It leaves companies fitter, leaner, and more prepared to face competition domestically and abroad."[161]

Even as he spoke, Belgian, French, and German banks were planning to expand abroad. But French

banks weren't expecting to make billions by competing in Germany, nor were German banks expecting to vanquish the French. Instead they were both heading south armed with cash they raised in their home countries at rates as low as 1 to 4 percent.

The reason to look abroad was simple: In the mid-1990s, national interest rates in Greece and Spain, for example, hovered around 14 percent, and at a similar level in Ireland during the 1992–1993 currency crisis.[162] So borrowers in these countries were eager to welcome the northern bankers with seemingly unlimited supplies of cheap cash. This rate differential allowed bankers to finance the most fanciful schemes, and politicians, as well as, to buy whatever they wanted.

> *"Entire countries were told, `The lights are out, you can do whatever you want to do, and no one will ever know.' "*
> *— Michael Lewis, Vanity Fair.*

"The tsunami of cheap credit that rolled across the planet between 2002 and 2007 … wasn't just money, it was temptation," financial writer Michael Lewis wrote in *Vanity Fair*. "Entire countries were told,`The lights are out, you can do whatever you want to do, and no one will ever know.'"[163]

There was another important incentive—the northern banks knew full well that losing their government backing put them at the mercy of the markets. A centuries-old history made little difference to their investors, who would dump shares in a perfectly good bank if they saw greater profit elsewhere.

So the banks figured that to beat the competition, they had to expand as quickly as possible into new markets. Each bank—in its own way—took major gambles. From Greece to the U.S. they snapped up anything that smelled profitable: They bought everything from smaller banks to subprime mortgages while they doled out loans for unlikely projects including movie sets and new highways for public municipalities.

Monti's belief that the restructuring of the banks would not cause major problems failed to factor in the fundamental uniqueness of banks: Unlike companies selling shoes or sausages that can rise and fall with barely a ripple for the rest of the country, banks anchor the entire economy. So when a few (or more) big banks fail, they can create havoc for everyone else.

But the big European banks in countries like Belgium, France, and Germany were confident that their governments would support them if there was a major crisis – after all, that had always been true. Indeed, the credit rating agencies supported this theory, by giving the "too-big-to-fail" banks higher ratings. This allowed the banks to borrow at a cheaper rate, which effectively amounted to an indirect subsidy.

In the next section, we will look more closely at three countries that borrowed heavily from these banks: Greece, Spain, and Ireland. •

Spain:
The Airport Without Planes, and the Never-Ending Property Boom

- **Where:** Spain.
- **What happened:** Seduced by low interest loans, local authorities and real estate speculators went on a spending spree. Initially prices skyrocketed for property before they crashed after 2008. Meanwhile the airports, roads, even movie sets that were built generated hardly any revenue.
- **Outcome:** Spain was forced to request up to €100 billion in potential loans by the European Financial Stability Facility and the European Stability Mechanism in exchange for strict restructuring of the banking sector. Borrowing costs hit 7.3 percent in July 2012.

A joke making the rounds in Spain: It's the first country in the world to inaugurate a pedestrian airport. Costa Azahar airport sits, without planes, just outside the Mediterranean town of Castellón. Welcoming visitors to this oddity is a 24-meter high copper statue of Carlos Fabra, the former regional boss of the right-wing Partido Popular (PP) and province head from 1995 to 2011. He was also the driving force behind the scheme that became a punch line.[164]

One of the principal backers of €150-million project was Dexia Banco Sabadell, which provided an €18.5 million loan, and joined with several other banks to issue a €39-million syndicated loan.[165] Two years after the airport was launched, not a single airline had scheduled flights, and the government had to guarantee the development loans.[166]

Parody of *The Terminal* poster. The caption reads: "Life is Expected, Just No Planes."

NOSEPUEDEVIC

Some 75 kilometers south, a five-star, luxurious Hilton hotel offers panoramic views of Valencia, Spain's third largest city. The €110-million project—financed by Eurohypo—opened in 2008, and declared bankruptcy a year later.[167]

Across the country, in Galicia, Depfa provided a €90-million loan to build a privately operated toll road, one of many that would struggle to generate sufficient revenue for the operators to pay back the lenders.[168] To the north, in the Basque town of Bilbao, Crédit Agricole financed the building of the Bilbao Exhibition Centre (BEC) as part of a syndicated loan of €150 million.[169] The project eventually cost some €600 million, once again at public expense.[170]

"German banks financed Spain's savings and commercial banks, which needed extra funds for high-risk mortgages," wrote Robert Tornabell, a professor of international banking and finance at Barcelona's ESADE Business School. "Developers got rich, selling the idea that everyone was going to win because property would always go up—never down—in value."[171]

This pipe dream of future prosperity was also promoted heavily by Spanish construction companies that were allegedly donating generously to politicians

Partido Popular campaign event in Castellón, November 2011.

PARTIDO POPULAR COMUNITAT VALENCIANA

in Partido Popular, which ran Spain from 1996 to 2004.[172]

For example, Fomento de Construcciones y Contratas (Barcelona) and Obrascón Huarte Lain and Sacyr Vallehermoso (Madrid)—made a series of undisclosed payments to senior party officials. The details were listed in handwritten notes kept by Luis Bárcenas, the party's former treasurer and his colleague Álvaro Lapuerta, according to an investigation by *El País* newspaper in Spain.[173]

Fueled by cheap loans and greased with bribes, Spanish public authorities and private developers embarked on a building bonanza. "During those giddy years, few wielded more power in Spain than its lords of construction, a group of men who used the country's post-dictatorship economic miracle to build their companies into behemoths feared more than they were loved," wrote Miles Johnson in a *Financial Times* account of the era.[174]

All three companies won billions of euros in Spanish government contracts and concessions during the boom times: For example, Fomento de Construcciones y Contratas estimated that it won over €3.75 billion in Spanish construction contracts in 2008, Sacyr estimated it won €2.55 billion in Spanish construction contracts that year, and Obrascón Huarte Lain reported €1.02 billion in domestic construction work in 2008.[175]

The money for this building spree had to come from somewhere. Big banks in Belgium, Germany, and France—recently released from the fetters of government ownership and regulation, and looking to expand across Europe—were more than happy to help.

Take for example Metrovacesa, once Spain's largest real estate company, which aspired to become the largest developer in all of Europe. It racked up €7 billion in debt buying properties all over the continent during the real estate boom, borrowing heavily from Hypo Real Estate.[176] In April 2007 Metrovacesa bought the most expensive U.K. property in history, the 45-story HSBC bank headquarters in Canary Wharf, London. The HSBC tower cost £1.1 billion (€1.35 billion), and was purchased with the help of a £810 million (€1 billion loan) from HSBC itself.[177]

A year and a half later, property values fell, and banks would not extend Metrovacesa additional credit. The company was forced to take a loss, and sell the Canary Wharf high rise back to HSBC to cover its debts.[178]

Eurohypo ran into the same problems. It owned a fifth of Inmobiliaria Colonial, a €12-billion property company with offices for rent in Barcelona, Madrid, and Paris that was forced to seek outside buyers in 2008 to stave off collapse.[179]

Provincial governments soon followed suit in declaring bankruptcy. When the money flowed, the province of Valencia splurged on a €2.4 billion harbor to host the 2007 America's Cup, €1.1 billion on the City of Arts and Sciences, and a Formula One racetrack inside the city.[180] In July 2012, it became the first to ask the Spanish government for a bailout—to help manage its €20.76 billion debt.[181] Within weeks, half of the country's 17 regions followed suit—asking for help paying off an astronomical €140 billion in debt.[182]

"Chancellor Merkel rightly criticized the Spanish [state] activities for allowing the development of [the real estate] bubble," wrote Vicente Navarro, professor of public policy at Pompeu Fabra University in Barcelona. "But she should have included German banks in that criticism."[183] •

Greece:
Of Disappearing Debt and Illegal Loans

- **Where:** Greece.
- **What happened:** Already heavily in debt from massive public-sector projects (notably for the military), it fiddled its books, with the help of Goldman Sachs, to join the euro. Then it borrowed even more for public-sector mega-projects like the Olympics.
- **Outcome:** Greece has been forced to borrow €207 billion in potential loans by the Troika in exchange for an austerity package. Borrowing costs hit 36.5 percent in February 2012.

In 2006 Yiannis Kazakos, the former mayor of Zografou, a suburb of Athens, arranged for his city council to borrow €25 million from Kommunalkredit International, the Austrian subsidiary of Dexia, to buy land in the middle of the council to build a shopping mall. [184]

Beggar outside Agios Dimitrios. His sign reads: "I am sick, and hungry. Please help me. Thank you."

ROBERT WALLACE (ROBW_)

Then came potentially deal-killing problems: First, construction on the land was not permitted; and second, the loan was illegal, city officials said, because the state's court of auditors had not approved it.[185]

For five years, city officials refused to repay the loans. Then in 2011, the IMF insisted that the government of Greece take on and repay the Zografou debt plus accrued interest—a total of €45 million—if it wanted to continue getting bailout money.[186]

Zografou was not the only council to ask Dexia for money for shaky municipal schemes. In 2006 Melisia and Volos Councils each borrowed €4.5 million from Kommunalkredit to buy up property for developing municipal squares.[187] Sypros Striftos, the mayor of Acharnon council, borrowed €20 million from Goldman Sachs, which in turn sold the debt to Dexia Credit Local.[188] Similar deals were conducted by the councils of Metamorfosis council, Nea Ionia, and Serres.[189]

While most of the mayors are gone, much of the outstanding municipal debt has simply transferred to the national government, under the agreements for the bail-out of Greece.

"In the 19th century, when foreign governments wanted to impose their will, they used gunships," Stathis Chatzopolous, a Greek lawyer told the *Guardian*. "Now they're using the IMF, the European Central Bank and the European community."[190]

In the 1990s, bad credit and high interest rates would have prevented the councils, and the Greek government for that matter, from this easy borrowing. But all this

IMF director Christine Lagarde meets with
Greek Finance Minister Evangelos Venizelos on July 25, 2011.

changed when Greece joined the third stage of the European Monetary Union (EMU), and became eligible to use euros and get cheap foreign loans.

This was no easy task since Greece had to demonstrate a government debt of less than 60 percent of gross domestic product and a budget deficit to GDP ratio of under 3 percent. Unfortunately, Greece debt exceeded 100 percent and deficits were at 3.7 percent.[191]The Greek government looked for external help for what *Der Spiegel* would later describe as "blatant balance sheet cosmetics."[192]

"When German taxpayers are righteously indignant at having to bail out Greece's creditors with their hard-earned euros, they should consider that their hard-earned euros of yesteryear financed corruption in Greece for the purpose of creating a massive Greek trade deficit."
—Criton Zoakos

Enter Goldman Sachs, a Wall Street investment firm, which, for a reported $300 million fee,[193] came up with an innovative solution in 2001. Its financial experts took advantage of a loophole that allowed countries to enter the EMU if they could demonstrate that they were lowering their debt and their budget deficit. To do this, Goldman Sachs sold Greece a "cross-currency swap" that gave the government cash up front in return for a big payment at the end of the loan period. The beauty of the arrangement was that since currency swaps were permitted by the European Statistical Agency (Eurostat), the debt and deficit appeared to shrink.[194]

On January 1, 2002, Greece joined much of the rest of the European Union in welcoming the euro as its physical currency. A pyramid of euro coins was built in the Syntagma Square in central Athens to celebrate the occasion.[195]

Once Greece was part of the EuroZone, it had no problem attracting low-interest loans from Belgian, French, and German banks eager to profit from an economy that appeared to have nowhere to go but up.

Unlike Spain, Greece did not see runaway speculation on commercial real estate although Eurohypo did set up an office in 2003, and finance projects in Athens and Thessaloniki. "The bank's real interest lies in very big projects of €50–€100 million and more, although it is accepted that there are not very many potential transactions of this size in the Greek market at this time," Kenny Evangelo, head of Eurohypo's Greek office told *Investing in Greece* in 2003. "Eurohypo would be happy if it could finance one relatively big project per year, together with four or five smaller properties."[196]

On the other hand, investors snapped up Greek government debt for new public schemes including the hugely expensive 2004 Athens Olympics and one of Europe's most expensive military budgets in relative terms. Hypo Real Estate bought €7.9 billion worth of Greek bonds, Dexia had €3.5 billion, while both Commerzbank and Société Générale had just shy of €3 billion.[197] WestLB also bought Greek bonds, and made loans to HLPAP, a Greek entity that runs the electric trolley system in the Athens and Pireas area.[198]

It should be noted that the historical Greek government debt—much of it acquired before joining the euro—was a result of decades of multibillion drachma government contracts. Most notable were those awarded to German companies including Ferrostaal and Siemens for expensive weapons systems, telecommunications systems, and even projects for the Ministry of Culture. These contracts were won via a system of bribes worth billions of euros paid out to officials in Greece's two leading political parties.[199]

In December 2008, Siemens agreed to pay a fine of $1.6 billion to the U.S. Securities and Exchange Commission, the U.S. Department of Justice, and German authorities to settle charges of some $1.4 billion in international bribes over the years.[200] Later in April 2012, Siemens paid out €270 million to settle charges of bribery in Greece.[201]

"When German taxpayers are righteously indignant at having to bail out Greece's creditors with their hard-earned euros, they should consider that their hard-earned euros of yesteryear financed corruption in Greece for the purpose of creating a massive Greek trade deficit," wrote Criton Zoakos in *International Economy* magazine. Zoakos estimates that as much as 10 percent of Greece's €235 billion cumulative debt went to bribes. "That trade deficit was in turn financed by German and other European banks at handsome, risk-weighted rates of return."[202]

Another sector that saw a huge influx of foreign cash after Greece joined the euro was the banking sector. As previously described, Emporiki and Geniki were acquired by Crédit Agricole and Société Générale respectively. The French bankers poured money and advice into major expansions of these two small banks because of their access to cheap money. The banks, however, proceeded to lose billions of euros.

In October 2012, Crédit Agricole agreed to sell Emporiki to Alpha bank of Greece for €1.[203] The same month Société Générale sold all of its shares in Geniki bank to Piraeus Bank of Greece.[204]

Sale of these two banks is still costing the Greek taxpayer dearly. By the end of June 2013, Alpha Bank and Piraeus Bank had borrowed €4 billion and €7 billion respectively from the Greek government, all of which had to be repaid with austerity.[205] •

Cyprus

Bank of Cyprus sign

- **What:** Laiki Bank, founded in 1901.
- **Where:** Limassol, Cyprus.
- **What happened:** It lost €12.3 billion on its Greek government bonds in 2011.
- **Outcome:** It was given a €1.8 billion bailout in April 2013 by Cypriot government and renamed Cyprus Popular Bank.

An unexpected side effect of the economic crash in Greece was the impact on neighboring Cyprus. After the 2010 collapse, the Bank of Cyprus and Laiki Bank—the two biggest banks in the country—bought large quantities of Greek bonds at 70 percent of their original value, only to see them decline even further in value after international lenders forced the Greek government to accept a "haircut" in the value of the bonds. This unleashed a domino effect that soon swept Cyprus into the Greek crisis.

The losses shone a spotlight on the role of Andreas Vgenopoulos, the Greek CEO of Laiki Bank, who made his reputation rescuing debt ridden shipping companies. During the boom, he invested the money he had raised in Cyprus in risky assets like Olympic Airways in Greece, which was losing €1 million a day.[206]

"When the Germans were selling, they were buying," Alexander Apostolides an economic historian at Cyprus' European University, told *Reuters*. "People are thinking in hope," added Simona Mihai, assistant professor at Cyprus European University's banking and finance department. "They do not see it from an analytical perspective."[207]

Laiki put up an astonishing 106 percent of its capital requirements into Greek bonds, while the Bank of Cyprus invested the equivalent of 75 percent of its capital needs.[208] (Banks are supposed to keep a percentage of their assets in low risk investments like cash and government bonds.) When Greek bonds were devalued, Laiki lost €2.3 billion, an amount equal to an eighth of the national gross domestic product, and the Bank of Cyprus lost €1.6 billion.[209]

In April 2013, Cyprus had to turn to international lenders for an emergency €10 billion bailout. Complicating the situation was the fact that Cyprus had become a tax haven for fabulously wealthy Russian oligarchs, whom ECB officials were extremely hesitant to bail out. Thus, for the first time, officials forced a "haircut" on private individual depositors. Anyone who had more than €100,000 lost 40 to 80 percent cut of their holdings.[210]

"[Vgenopoulos's] rise and fall underscores how Southern Europe's one-time economic renaissance was built on low interest rates and a giddy, debt-fueled boom that papered over deep structural problems," wrote the *Wall Street Journal*.[211] •

LEONID MAMCHENKOV

Ireland:
From Miraculous Beast to Failed Civilization

- **Where:** Ireland.
- **What happened:** It established a low tax, light regulation international financial center, and ignored an unsustainable construction boom with astronomical property prices. Banks were making loans against other loans with no physical collateral.
- **Outcome:** Ireland has been forced to request €85 billion in potential loans by the Troika in exchange for an austerity package. Borrowing costs hit 13.8 percent in July 2011.

The Celtic Tiger "appeared like a miraculous beast materializing in a forest clearing," wrote Oxford historian Roy Foster in his recent book: *Luck and the Irish: A Brief History of Change 1970–2000*. "Economists are still not entirely sure why."[212]

European Day Of Action protest march outside Anglo Irish Bank in September 2010.

WILLIAM MURPHY (INFOMATIQUE)

The embodiment of this fabulous creature—a dazzling city of emerald green glass and steel—arose in the 1970s and 1980s from the abandoned dockyards of the River Liffey in poverty stricken Dublin.[213] These sleek new buildings housed the International Financial Services Centre (IFSC). Established in 1987, this "offshore" haven intended to attract Fortune 500 businesses from all over the world with its special limited-time tax incentive rate of 10 percent. (The rest of Ireland has a 12.5 percent tax rate that was still among the world's lowest.)[214]

The scheme drew a tight concentration of major European banks. If you stand in front of the *Jeanie Johnston*, a replica of a boat that took 19th century Irish emigrants to the Americas, you can look straight down Commons Street at the headquarters of Depfa. Just beyond it, on Harbourmaster Place, sits Deutsche Bank. To your left are Dexia inside Touche House and the headquarters of the IFSC. To your right is the new Dublin Convention Center, financed by Depfa, and then an unfinished building intended as headquarters of Anglo Irish Bank. Swivel around, and across the bridge on George's Quay are the old offices of Sachsen Landesbank (Sachsen LB) from Leipzig in Saxony.

At the top of the bull market in summer 2006, each of these banks was doing a roaring trade. Kestrel Funding PLC, a €5 billion venture named after the hunting falcon, was launched by WestLB in August, and registered at the Harbourmaster Place offices of Deutsche Bank.[215] It was the latest in a list of risky funds named after birds of prey—in keeping with German bank's aggressive personality.[216]

One month later, Depfa announced that it was to raise a €280 million loan for a new convention center.[217] In December, Moody's raised Sachsen LB's rating to Aaa.[218]

Ghost estate in Ballisodare, Ireland.

DAVID LENAHAN. USED WITH PERMISSION. ALL RIGHTS RESERVED.

Both WestLB and Sachsen had tens of billions financed through a range of risky financial vehicles that they set up in Ireland, which issued complex instruments like asset-based commercial paper (ABCP.)[219]

"The base characteristic of these structured finance vehicles is that these operating companies are allowed to issue debt or enter into financial obligations without recourse to the rating agencies," explained Douglas Long in a 2006 anthology written for *Euromoney*.[220]

Kestrel was one such SIV. WestLB also had similar conduits and ABCP-type funds based in other international financial capitals and offshore locations that boasted avian names such as Blue Heron, Greyhawk, Harrier, and Whitehawk as well as the less predatory designations, Compass and Paradigm. Together they held some €35 billion in debt issued by the WestLB. [221]

Sachsen LB also had SIVs George's Quay and Ormond Quay (named after Dublin streets) worth more than €17 billion. These were structured to profit from the difference in interest rates for long-term asset-backed securities such as credit card debt or mortgages and those for short-term borrowings. (Ormond was set up with help from Lehman Brothers).[222]

Why did so many international businesses set up shop at the IFSC to hawk their wares to Irish and other investors in Dublin?

Many theories—all with some truth to them—were touted to explain Foster's miraculous beast: the low tax rates, proximity to London's global financial center, low wages and the universality of the English language, and even the €17 billion in grants that the E.U. provided to help pull Ireland from the bottom of the European economic rankings.[223]

But most important was the light-touch financial regulation. By accepting reports at face value, Dublin made itself especially attractive to banks that were playing fast and loose with lots of money.

This was perhaps best embodied in the unusual alliance between a local property finance bank, Anglo Irish Bank, and Irish entrepreneur Sean Quinn. Founded in 1964, Anglo Irish gained a reputation for lending quickly for risky projects at a higher rate of interest that swelled its profits. Quinn, who started his career in 1973 quarrying gravel on his family farm, eventually built a fortune in manufacturing by undercutting his competitors.[224]

When Ireland joined the euro in 1999, investors flocked to the IFSC flush with billions of euros to spend. Anglo Irish jumped in to channel this money to businessmen like Quinn to develop land holdings all over the country. As the building frenzy intensified, and with nobody checking the books, Anglo abandoned all caution and started to accept one mortgaged property as collateral for the next.[225]

By 2006, one in five workers in Ireland was in the construction industry, and lending to the sector totaled 28 percent of all lending (compared to 8 percent in the rest of Europe).[226] Ireland was building more than seven times as many houses per capita as the U.K., and prices had risen five fold over 1994.[227] By 2007, even Irish farm land was worth €66,000 per hectare, the highest in Europe, and the Irish had borrowed twice as much as their gross national product.[228]

"Competitiveness didn't matter. From now on we were going to get rich building houses for each other."
—Morgan Kelly

"Competitiveness didn't matter," Morgan Kelly, an economist at University College Dublin told *Vanity Fair*. "From now on we were going to get rich building houses for each other."[229]

Property developers threw lavish parties. One paid €1.5 million to rent a 17th century villa for his second wedding, and then, for a similar price, took the guests on a two-week Mediterranean cruise on Aristotle Onassis's old yacht.[230] Anglo Irish chartered private jets to fly wealthy clients from the U.S. for golf vacations, spending €200,000 on golf balls alone.[231]

In 2008, Quinn was the wealthiest man in all of Ireland, worth €4.722 billion. What few people knew was that he had built up a significant ownership in Anglo Irish by gambling on their shares.[232]

And the biggest "Irish" bank of all was Depfa, the former public-sector mortgage bank, with assets of over €218 billion but just 319 employees in Dublin.[233]

The 2007 Crash

The crash began in late summer 2007. Rumors had already started to circulate about a looming crisis on subprime mortgages, and many banks had stopped making short-term loans, choosing instead to hoard their cash. With no easy money to borrow to finance its long-term loans, the landesbanken—notably Sachsen LB—that were speculating on interest rate differences hit a wall.

On August 24 Bundesbank officials summoned representatives of the major German banks to Frankfurt. "[You] are still clinging to the hope that the markets will spring back to life, and there will be a happy end," Jochen Sanio, head of banking regulator BaFin, told Sachsen at a closed-door meeting. "If we don't act today, I don't see how you will survive Monday."[234]

The Bundesbank agreed to give Sachsen a €17-billion lifeline to keep it from going under.[235] But it was not the only one on the edge of disaster: Kestrel posted a $402-million pretax loss that year, followed by a $668-million loss in 2008.[236] Pretty soon, the financial world also woke up to the fact that Quinn owned a quarter of the bank that loaned him all his money. Smart investors started to dump Anglo Irish shares.

A year later, Lehman brothers collapsed, and any meaningful volume of interbank lending ceased. With no access to short-term cash to roll over its property Ponzi scheme, the Irish economy went up in smoke. Anglo Irish and Depfa collapsed. Fortunately for the Irish, Hypo Real Estate had just bought Depfa. That meant that Germany was stuck with the €102 billion bailout, but Ireland was still on the hook for Anglo Irish, which would eventually cost it €30 billion.[237]

The new headquarters that Anglo Irish was building at the IFSC was abandoned, as were hundreds more projects to the tune of 100,000 housing units. The *Economist* described the "ghost" estates left behind as "an apocalyptic sight. … Rubble and rubbish lie everywhere. With wind howling and rain lashing, it is easy to imagine

that you are gazing on the ruins of a failed civilization. And in a way you are."[238]

The Irish government scrambled to assure the public that it would guarantee the banks, but this promise made people even angrier. "Our Future Killed by Wanker Bankers and Stupid Politicians" screamed a headline in the *Irish Daily Star*.[239] "Greedy, Rotten, Liars" exclaimed another headline in the *Daily Mirror*.[240]

Who exactly is the Irish taxpayer paying back? Nobody knows the precise numbers, but a blogger named Guido Fawkes published a list of Anglo Irish bondholders—and many turned out to be French and German banks.[241]

There was "institutional incompetence by German managers who encouraged profitable, risky activities in Ireland," wrote Derek Scally, a financial reporter at the *Irish Times*.[242] He cited in particular a 556-page investigation into Sachsen that German prosecutors commissioned.[243] Karl Nolle, a Dresden politician who took part in the investigation, was more scathing: "Dublin was the cash cow, and they thought it could be milked for profit," he said. "It was like a gambling addiction."[244]

Some tried to get their moneyback. In 2009, WestLB was sued in a New York court for $492 million in losses from Kestrel. The plaintiffs were a strange ménage of Anglo Irish Bank, Bank Hapoalim, and Mizrahi Tefahot Bank of Israel, as well as by the Libyan central bank and the sovereign wealth funds of Abu Dhabi and Kuwait.[245] Separately Anglo Irish also sued WestLB in U.K. courts over a $42 million loss from a purchase of LSS notes (a kind of derivative).[246] Both cases would eventually be dismissed by judges who said that the buyers should have done their homework.

In a final irony, WestLB decided to separate its most toxic assets into Phoenix, a €23 billion "bad bank" that it registered in Dublin in February 2009.[247] It has yet to rise from the ashes. WestLB was shut down on June 30, 2012.[248] •

Conclusion:

Odious Debt

November 15 rally against austerity in Madrid.

POPICINIO (ADOLFO LUJAN)

The three countries we have described—Greece, Ireland, and Spain—now face years of crippling debt to pay for the last decade's lending spree by Belgian, French, and German banks.

In April 2010, Greek bonds were downgraded to junk status. Interest rates in the markets skyrocketed, making it too expensive for the government to borrow money. Desperate, Greece asked the "Troika" of the E.U., the ECB, and the IMF for a bailout. The lenders agreed to provide €110 billion on condition that Greece impose "austerity": slash its social spending and privatize state assets.[249]

Austerity suggests that the Greek citizenry had been lazy and profligate. Yet a study by Patrick Artus, chief economist at the French bank Natixis, showed that the average Greek worker averages 2,119 hours a year compared to 1,390 hours for Germans, and 1,554 hours for the French.[250]

"There is … a profound sense of bewilderment at a situation from which there appears no escape, and to which the only response is a call for more economic pain made by some of the same people who created the fiasco," wrote Jason Manolopoulus, a Greek hedge fund manager.[251]

Ireland was next in line with its hand out. In November 2010 the Troika bailed it out with €67.5 billion, which Ireland supplemented. It took €17.5 billion from its own reserves and pensions to finance the government deficit

Left Party France poster. The caption reads: "Europe: Say no to austerity deal"

JEANNE MENJOULET

and to pay off the debts of three banks—Anglo Irish Bank, Allied Irish Bank, and Bank of Ireland.[252]

"The Celtic Tiger became a bedraggled alley cat," Finan O'Toole observed sarcastically in his 2009 book, *Ship of Fools*.[253]

In October 2011, Greece negotiated a second bailout of €130 billion, this time for yet more austerity and privatization and an agreement to slash bondholder payouts. In February 2012 the bond owners agreed to a "haircut" of 53.5 percent of the value of their holdings.[254]

But not everyone did badly. Indeed, some savvy investors turned a profit by waiting until after the Greek haircut to buy Greek bonds when they hit rock bottom. They wagered correctly that the Greek government would want to redeem them at a higher value to salvage its financial reputation.

This past winter Dan Loeb of Third Point Capital made a quick $500 million selling bonds,[255] while Manolopoulos and his business partner Achilles Risvas from Dromeus Capital also turned a sizeable profit.[256]

Spain, too, has had to tap the "Troika" for money, asking for a €100 billion credit line in June 2012. It took out some €50 billion in December 2012 to buy up the real estate assets of its troubled banks, which it placed in a "bad bank" named Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (Sareb).[257]

There was little choice for these three countries—at the height of the crisis, each country was hit with astronomical rates. In February 2012 the Greeks had to pay 36.5 percent to borrow money in the 10-year bond market; in July 2011 the Irish had to pay 13.8 percent; while in July 2012 the Spaniards had to pay over 7.3 percent. (The rates have since dropped. In mid-September 2013, 10-year bond yields were 10.3 percent for Greece, 4.2 percent for Spain, and 4 percent for Ireland).[258]

By contrast, the markets made money available to the German government at a rock-bottom rate interest rate of 1.17 percent and to the French at 1.66 percent in May 2013. (The rates dropped after the ECB pledged to use all its power to keep them low in 2012.)[259]

What's ironic is that until the crash of 2008, the finance ministries in most of the borrowing countries were relatively prudent compared to the finance ministries in the lending countries. For example, the Irish and Spanish governments had borrowed less than Belgium, France, Germany, and the U.K. The Irish owed roughly 25 percent of gross domestic product (GDP) in 2007; the Spaniards owed 36 percent. Meanwhile the Belgians had borrowed 84 percent, the French and German government had taken out 65 percent. (Greece was a notable exception with well over 100 percent debt to GDP ratio).[260]

The *BBC*'s Laurence Knight notes: "Madrid was in the process of paying its debts off—it earned more in tax revenues than its total spending. In contrast, Berlin regularly broke the maximum annual borrowing level laid down in the Maastricht Treaty of three percent of GDP." The same was true of France.[261] (In fact, these rules turned out to be irrelevant since they did not account for the real problems at play.) •

Time to Investigate the Bankers and Bureaucrats

José Manuel Barroso, President of the European Commission, speaking at the EuroZone Summit in October 2011.

PRESIDENT OF THE EUROPEAN COUNCIL

In her new book, *A Dream Foreclosed: Black America and the Fight for a Place to Call Home*, Laura Gottesdiener explains that 30 years ago, African Americans were unable to borrow money to buy houses because of a practice called redlining—where banks drew fictitious red lines around neighborhoods they would not lend to even if the borrowers had good credit and good jobs.[262]

Today, redlining is illegal, but the reverse has happened. In the 1990s, poor people around the U.S. were offered 100 percent loans to buy houses at low rates with virtually no collateral.

"The mortgage market for white Americans was flush. There was no more money to be made from issuing mortgages to white Americans. The banks needed new consumers," Gottesdiener told *Corporate Crime Reporter* magazine. "So, they moved into the minority market. But they weren't selling the conventional loans. They were selling these incredibly exploitative predatory loans."[263]

Gottesdiener says the banks weren't worried about repayments. "The banks, under the securitization process, could sell the loan off and receive the money pretty much immediately," she added.

She labels this "clear cut fraudster behavior" since the bankers knew that the housing prices couldn't go up forever. "They knew it was a house of cards."[264]

Eventually when enough of these loans could not be paid back, the house of cards collapsed, the poor were evicted, their borrowing costs skyrocketed, and the banks turned to the U.S. government to be rescued.

Likewise, French and German bankers were under pressure from the European Commission to compete to survive after the euro was launched in 1999. "For us, size is not a relevant aspect of our business," Heinz Hockmann, the CEO of Eurohypo said at the time. "It's profits."[265]

Michael Lewis, the financial journalist, expands on this idea: "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," he wrote in *Vanity Fair*.[266]

Belgian, French, and German bankers were ready to take such bets since they believed the governments

would back them up. "For the bankers it was always clear: The German government would never allow big German banks go broke, there was an implicit guarantee for them," Henrik Enderlein, a German economist at Berlin's Hertie School of Governance told the *Irish Times*. "It was as if you gave a gambler multimillion loans and sent him into a casino."[267]

Some German regulators say that they are now aware of the mistakes they made. "With the knowledge of today there are certain things one did then that we would not repeat," Jörg Asmussen, an ECB's executive board member told the same newspaper in March 2013. "I believe that, indeed, the wave of deregulation had gone too far and that is now being corrected after painful experience."[268]

The time has come for the audience to go behind the scenes, to investigate the bankers who created the EuroZone crisis and hold them accountable.

But the European bankers and bureaucrats are actually feeling no pain. For many of them, life has returned to business as usual. The agony has been shifted to the politically powerless and the poorest of the poor in Greece, Ireland, and Spain.

Earlier this year two new theatrical productions opened on stage at the Deutsches Theater in Berlin and the Olympia Theatre in Dublin respectively: *The Raspberry Reich* and *Anglo: The Musical.*

In the German play, six actors portray 20 bankers who were interviewed by Andres Veiel, the director, about their role in the disaster. They put the blame on their government regulators who called them to a meeting in the late 1990s to tell them that they needed to expand and compete with London and New York.[269]

"We should … get into more risk, expand the derivatives and structured finance products, finally get modern," one of the bankers says they were told. "We were read the riot act."

The Irish play uses giant puppets to tell the story of the boom times and the aftermath in Ireland. "The people … are greatly under-borrowed," Rich, the fictional CEO of Anglo Irish, tells one of his junior bankers whom he urges to promote the "the bank that won't say no."

Jimmy, the junior banker, convinces his cousin, a drum maker, to borrow €890 million to build a 40-story apartment and shopping mall complex on his small remote island, while the chorus sings "Put a Zero on the End, He's a Friend."[270]

Eventually, the economy collapses and the actors portray a scene in which the Irish prime minister appears on stage hauled by German Chancellor Angela Merkel at the end of a leash. Confronted with the financial mess, Merkel is asked who will repay the banks. "Why, zeeze nice people, of course," she says in an exaggerated accent, pointing at the audience.

The time has come for the audience to go behind the scenes, to investigate the bankers who created the EuroZone crisis and hold them accountable. But the bankers are not the only ones. There must be repercussions for the E.U. bureaucrats and politicians who promoted the idea that free-market competition in financial services would benefit everyone. And not least of all, there should be a serious debate on how to reverse many of the policies that were used to create the European single market in financial services.

"The political elites accept tremendous unemployment, poverty, and misery—to save a financial sector beyond remedy. It is a scandal that the European Commission publishes hundreds of pages of reports but fails to specify where the money went to exactly," says Lisa Mittendrein of ATTAC Austria. "Banks 'too-big-to-fail' have to be split and return to serving public welfare instead of private profits. Creditors and the rich have to pay their share of the crisis's costs while the financial sector must be severely regulated."[271] •

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p11 Tembo meets Bull and Bear at the Frankfurt Stock Exchange, May 2005.
Photo: https://connect.businesswire.com/bwapps/mediaserver/iewMedia?mgid=45308&vid=5&download=1

p12 Chancellor Angela Merkel addresses the European Parliament.
Photo: European Parliament
http://www.flickr.com/photos/european_parliament/8164240080/

p13 German euro coin
Photo: Bastian K. (basi_16816)
http://www.flickr.com/photos/11559145@N04/2040695210/

p14 WestLB advertisement.
Photo: WestLB 2011 Annual Report
http://www.portigon.com/cm/content/portigon/i/en/ueber-portigon/westlb-archiv/finanzberichte/finanzinformationen--geschaeftsberichte.html

p16 Greenpeace protest outside Hypo Real Estate offices in Frankfurt, March 2009. The caption reads: "If the world were a bank, you would have already saved it.
Photo: kellerabteil
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p19 Eurohypo offices in Berlin.
Photo: will schrimshaw (poportis)
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p21 Banque de France offices in Paris.
Photo: Doug (caribb)
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p22 French euro coin.
Photo: Pascal (pasukaru76)
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p23 Société Générale headquarters in Paris.
Photo: Romain
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p24 Parody of poster for French film: Bank Error in Your Favor.
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p25 Protest outside Emporiki bank in Komotini, Greece, in 2009.
Photo: Joanna PIAZZA del POPOLO
http://www.flickr.com/photos/piazzadelpopolo/3953044566

p27 Dexia advertisement: "More insight into your future through Dexia."
Photo: Duval Guillaume
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p28 Dexia ATMs in Antwerp.
Photo: harry_nl
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p31 Mario Monti, former E.U. Competition Commissioner.
Photo: President of the European Council
http://www.flickr.com/photos/europeancouncil/6388027727/

p33 Parody of *The Terminal* movie poster. The caption reads: "Life is Expected, Just No Planes."
Photo: nosepuedevlc
http://www.flickr.com/photos/nosepuedevlc/6730115319

p34 Partido Popular campaign event in Castellón, November 2011.
Photo: Partido Popular Comunitat Valenciana
http://www.flickr.com/photos/popularesvalencianos/6394204153

p35 Beggar Outside Agios Dimitrios. His sign reads: "I am sick, and hungry. Please help me. Thank you."
Photo: Robert Wallace (RobW_)
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p36 IMF director Christine Lagarde meets with Greek Finance Minister Evangelos Venizelos on July 25, 2011.
Photo: International Monetary Fund
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p38 Bank of Cyprus signs.
Photo: Leonid Mamchenkov
http://www.flickr.com/photos/mamchenkov/146188759/

p39 European Day Of Action protest march outside Anglo Irish Bank in September 2010.
Photo: William Murphy (infomatique)
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p40 Ghost estate in Ballisodare, Ireland.
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http://zxcode.com/2011/05/the-mill-apartments-ballisodare/

p43 November 15 rally against austerity in Justicia, Madrid.
Photo: Popicinio (Adolfo Lujan)
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p 44 Left Party France poster. The caption reads: "Europe: Say no to austerity deal"
Photo: Jeanne Menjoulet
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p45 José Manuel Barroso, President of the European Commission, speaking at the EuroZone Summit in October 2011.
Photo: President of the European Councilhttp://www.flickr.com/photos/europeancouncil/6279444883

Back cover: Montage of Société Générale headquarters in Paris.
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