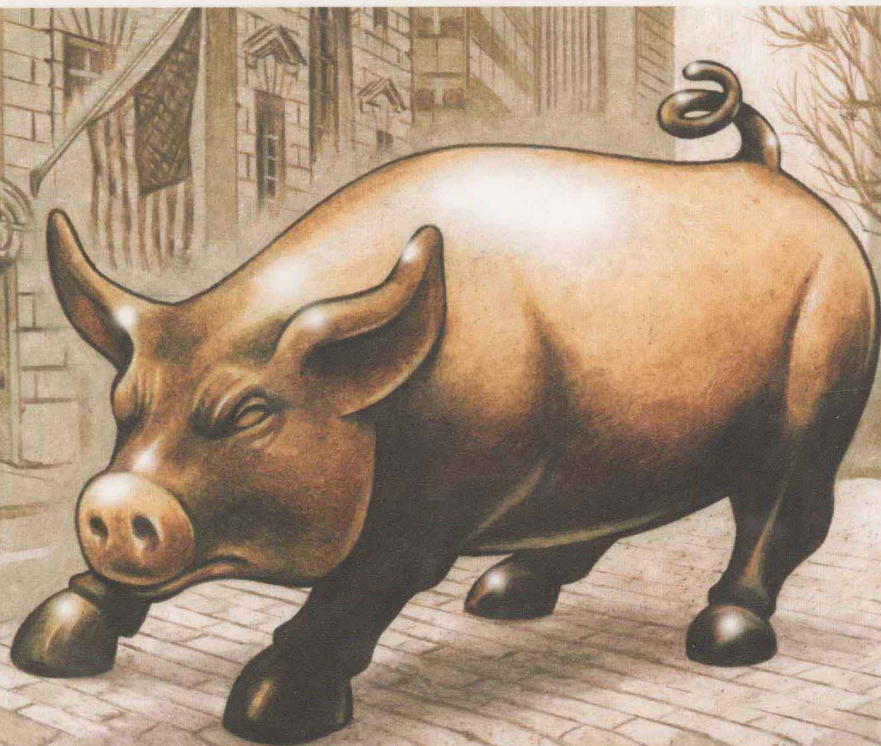


"A beam of enlightened thinking in a sea of delusional complacency."

—Nouriel Roubini

BAILOUT NATION



**HOW GREED AND EASY MONEY CORRUPTED WALL STREET
AND SHOOK THE WORLD ECONOMY**

BARRY RITHOLTZ

with Aaron Task

FOREWORD BY BILL FLECKENSTEIN

Author of Greenspan's Bubbles

Bailout Nation

*How Greed and Easy Money
Corrupted Wall Street and
Shook the World Economy*

Barry Ritholtz
with
Aaron Task



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Praise for *Bailout Nation*

“The greatest economic calamity in a generation has now swept from Wall Street through Main Street, to Iceland, Europe, and beyond. Barry Ritholtz not only saw the financial tidal wave coming, but tried to warn us before it hit, when few believed anything like it could happen. Now that clean-up is at hand, who better to explain what went wrong? Read this book: when Barry Ritholtz speaks, as the saying goes, attention must be paid.”

—Jeff Matthews

Author, *Pilgrimage to Warren Buffett's Omaha*

“This thrilling page-turner is really a doctoral thesis in disguise on the history of financial debacles and the inner workings of the global financial system and modern economics. Barry is truly one of Wall Street's important thinkers and rising stars. Bravo Barry!”

—Jeffrey A. Hirsch

Editor-in-Chief, *Stock Trader's Almanac*

“Barry Ritholtz, long known to readers of *The Big Picture* for telling it like it is, does exactly that in *Bailout Nation*. With sparkling clarity and his inimitable brashness, Barry names names and tells you where to look for the bodies who are profiting from the unprecedented \$8 trillion government bailout.”

—Michelle Leder

Author, *Financial Fine Print* and *Footnoted*

“Part history lesson, part social commentary, part in-depth analysis, *Bailout Nation* serves up a riveting indictment of the age of hubris and excess.”

—Michael Panzner

Financial Armageddon

“As Wall Street wizards were turning into welfare kings, Barry Ritholtz was there to chronicle every new outrage on his blog, *The Big Picture*. Now he’s focused on the really Big Picture—how we got into this mess—with his great new book, *Bailout Nation*.”

—Jesse Eisinger
Portfolio

“Barry Ritholtz crystallizes the absurdity of the bailouts and why America’s addiction to them is doomed to fail. This should be required reading for every future politician with a conscience.”

—Herb Greenberg
former journalist, CNBC, Marketwatch, and now
director of GreebergMeritz Research & Analytics

“Barry Ritholtz is leading the first wave of critical analysts who are trying to make sense of the past year beyond the official explanations. He not only illustrates the conflicts and contradiction in current economic leaders and policies, but suggests some solutions and even opportunities in this sea of global financial misery. I’m already looking forward to volume two.”

—Christopher Whalen
Institutional Risk Analytics

“*Bailout Nation* provides a timely review and analysis of the issues and problems that led to and are evidenced in the present financial turmoil. These forensics are much needed today.”

—David Kotok
Cumberland Advisors

“Barry Ritholtz has a one-two combination punch of insight and skepticism that leaves financiers, bankers and politicians out cold on the floor. This is pungent and funny required reading about the current crisis.”

—Dr. Paul Kedrosky
Infectious Greed
Partner, Ventures West VC

Bailout Nation

*To Wendy,
who has bailed me out of more than a few jams*

Foreword

Do you find yourself wondering: *How did we get here?* How did the United States of America get into such a predicament whereby in one year, 2008, the financial system nearly vaporized, the stock market crashed, real estate tanked, and major corporations were being bailed out (or begging to be) on a regular basis. How did our great country, a bastion of capitalism, devolve into a Bailout Nation where the gains were privatized but the losses were socialized?

This terrific book by Barry Ritholtz will explain to you how this sorry state of affairs came to pass. By reading it you will come to understand how we got here, which is a necessary prerequisite for understanding how to navigate the future.

The primary reason that I wrote *Greenspan's Bubbles: The Age of Ignorance at the Federal Reserve* (McGraw-Hill, 2008) was so that when the U.S. credit/housing bubble inevitably burst, people would understand why such enormous financial and economic problems were occurring, seemingly erupting out of nowhere. But they didn't erupt out of nowhere; these problems were created over time by the monetary policies of the Federal Reserve, specifically the targeting of interest rates and the Fed's ongoing refusal to recognize the flaws in this approach.



Although nearly everything that has transpired since my book was published in February 2008 I had expected to occur, I was still shocked by the total collapse of so many major financial firms, such as Bear Stearns, Countrywide Financial, Fannie Mae, and Freddie Mac in such a short amount of time.

But that is what happens to highly leveraged financial entities when significant portions of their underlying assets are found to be essentially worthless. The mind-set of deregulation that was championed by Federal Reserve Chairman Alan Greenspan in the wake of the Long-Term Capital Management (LTCM) bailout in 1998 is partially responsible for the massive overleveraging of nearly the entire financial system in the United States.

That Wall Street bailout (which led to the notion of the “Greenspan put”) set the stage for what we are witnessing today in the United States (and in the United Kingdom), with the prudent being forced to bail out the reckless. As Barry notes, “The parallels between what doomed LTCM in 1998 and what forced Wall Street to run to Washington for a handout in 2008 are all there.”

The United States has abandoned its capitalist roots, and the country has morphed into a Bailout Nation; now almost any large entity that finds itself in trouble feels the government (taxpayers really) should provide financial support. Similarly, homeowners who overextended themselves also feel that they too should be rescued from their mistakes.

Barry weaves together the problems created by the Federal Reserve’s interest rate targeting policies with the determination on the government’s part to thwart the “creative destruction” aspect of capitalism. We have now arrived at a juncture where our government seems to embrace free markets only when they deliver the results it wants. If they don’t, an attempt is made to alter the outcome, leading to unintended consequences down the road, which often are more severe than the original problem.

Ritholtz also names the villains in this tragedy—the rogues’ gallery of politicians and officials who screwed up big time—and demonstrates what they did to make the problem either bigger or worse. He also shows how each bailout throughout modern history has impacted what happens in the future—for example, why Chrysler should have been



allowed to fend for itself in 1980, and the impact that has on future bailouts.

This book is the history of how the United States evolved from a rugged, independent nation to a soft Bailout Nation, one in which too few question why we ask the taxpayers “to allow financial firms to self-regulate, but then pony up trillions to bail them out.”

However much we dislike the predicament we are in, the only way it can be remedied is if people learn in some detail what has transpired and so, armed with knowledge, demand change. Reading this book will prepare you to be able to do just that.

BILL FLECKENSTEIN

March 2009

Acknowledgments

All books are collaborative efforts, and *Bailout Nation* was more so than most. There were many people whose contributions were crucial to getting this project off the ground, and keeping it going when things started to falter.

Over the course of the past year, I wrote this book while working in an asset management firm, heading a research shop, all the while running a very active blog. This book was possible only thanks to the many helping hands involved.

Much of the book was written in real time, and early versions of parts of this appeared on *The Big Picture* (www.ritholtz.com). I would post ideas a few hundred words at a time, and readers would critique, poke, and prod my thought process along. These brave souls have my everlasting gratitude. Many of the insights, quotes, obscure references, and artworks within the book come courtesy of them.

There were many professional journalists and writers who selflessly shared sources, ideas, and insights with me. In particular, Dan Gross, Jesse Eisinger, Randall Forsyth, and Herb Greenberg all greatly impacted my process. If there are any parallels between my book and Dan's, it's because we batted more than a few ideas off of each other. Special thanks



go to Thomas Donlan of *Barron's*, who took my disjointed ramblings in *A Memo Found in the Street* ("Dear D.C.") and turned them into a concise thing of beauty.

Numerous other authors were helpful with the process of writing a book, as well as influencing my own research and writing. I owe special thanks to Nouriel Roubini, Bill Fleckenstein, and Michael Panzner for advice and comfort. Various fund managers and analysts generously shared their insights, most notably Doug Kass, James Bianco, Scott Frew, Chris Whalen, and David Kotok.

I grew up in a household where stocks and real estate were fodder for dinner-table conversations. My now-retired mother was a successful real estate agent, and used to regale us with dark tales of corruption and criminality in the real estate business (especially about C1 and C2). Her subversive view of the industry she worked in definitely rubbed off on me. (Thanks, Mom!)

The artwork in the book came to me courtesy of a few fantastic artists: John Sherffius of the *Boulder Daily Camera* is the creator of the fabulous jacket illustration to *Bailout Nation*. His political cartoons are also at the beginning of each of the five parts of the book. His dry wit and deft pen strokes communicate more with one picture than I can with thousands of words. J. C. Champredonde is the wicked mind behind the investment banks as casinos illustrations. You will find his work toward the end of the casino capitalism chapter and on the Web at www.stereohell.com. His art perfectly captures the past decade of casino capitalism. Jess Bachman of WallStats.com did amazing work on the Anatomy of a Crisis. R. J. Matson lent us a cartoon—corporate welfare.

Special thanks also go to Bill McBride of Calculated Risk for his informative real estate charts, and to Ron Griess of The Chart Store for the historical market charts.

Few writers particularly enjoy being edited. I was fortunate at TheStreet.com to work with Aaron Task—a rare editor who genuinely makes your work better (as opposed to merely different). When McGraw-Hill first approached me about doing this book (more about them later), I knew without question who I was willing to entrust my words to. Aaron's contributions, organization, and constant urgings forward are the prime reason this book got to the publisher on time in



December 2008. It's been said a book is done when the manuscript is torn from its writer's hands, and Aaron made sure that when that date came, what was being torn was something readable.

Much of this book involves dollar amounts, dates, data, and numbers. Staying on top of that would not have been possible without a crack research team, and I was fortunate to have worked with three of the best: Eugene Ashton-Gonzalez and William J. Miller were terrific, and my research intern, Ariel Katz, deserves special praise for her insights. She graduates from business school in May 2010, and some lucky company should snag her right away. Special thanks also go to Marion Maneker, for his gentle shoves in the right direction and his insights into the world of publishing.

Jeanne Glasser at McGraw-Hill was uniquely patient in dealing with writing a book about live events as they happened. When that publisher took issue with my criticisms of Standard & Poor's (a division of McGraw-Hill), Jeanne fought hard for the book. That the book in your hands ended up at John Wiley & Sons—and Jeanne at FT Press and Wharton School Publishing—tells you something about character. And I would be remiss if I did not add that Lloyd Jassin, my literary agent, went above and beyond the call of duty throughout. As you might imagine, this was not the typical book deal.

Speaking of which: I am thrilled to be published by Wiley. The people there were especially excited about this project. It was a pleasure working with Kevin Commins and Meg Freeborn and the rest of the Wiley crew.

Perhaps this is an acknowledgment first, but I have to give a shout out to Google Docs—the collaborative editing process would have been a bear without it. We had so many different versions of each chapter floating around before we started using it. G-Docs made staying on top of the latest changes and edits a breeze. Chalk one up for cloud computing.

On a personal note, my wife showed infinite patience during this lost year of writing *Bailout Nation*. If it wasn't for her, this book would never have been finished. (*Go for a walk! You're babbling again! Stop procrastinating! And for goodness' sake, will you take a shower already!*)

I must also express my gratitude to my partners at FusionIQ, Kevin Lane and Mike Conte, who gracefully allowed me to take many days off



to finish this beast and to close the door to my office to bang out a few more pages during the workweek.

Many additional authors colored my worldview, and much of what you read is due to the prior work of Roger Lowenstein, Richard Bookstaber, Tom Metz, Paul Desmond, Stephan Mihm, Satyajit Das, Robert J. Shiller, Robert F. Bruner and Sean D. Carr, Reginald Stuart, and Ed Gramlich. Their writings influenced what you now hold in your hands, and if it's any good, it's because I stole only from the very best.

Contents

Foreword	xiii
Acknowledgments	xvii
Introduction Bailout Nation	1
PART I A BRIEF HISTORY OF BAILOUTS	7
Chapter 1 A Brief History of Bailouts	9
Chapter 2 The Creation of the Federal Reserve, and Its Role in Creating Our Bailout Nation	13
Chapter 3 Pre-Bailout Nation (1860–1942)	21
Chapter 4 Industrial-Era Bailouts (1971–1995)	33
<i>Intermezzo</i> <i>A Pattern Emerges</i>	45
PART II THE MODERN ERA OF BAILOUTS	51
Chapter 5 Stock Market Bailouts (1987–1995)	53
Chapter 6 The Irrational Exuberance Era (1996–1999)	63



Chapter 7	The Tech Wreck (2000–2003)	75
Chapter 8	The Backwards, Rate-Driven Economy	89
<i>Intermezzo</i>	<i>A Brief History of Finance and Credit</i>	101
Chapter 9	The Mad Scramble for Yield	105
PART III	MARKET FAILURE	117
Chapter 10	The Machinery of Subprime	119
<i>Intermezzo</i>	<i>A Memo Found in the Street: Uncle Sam the Enabler</i>	130
Chapter 11	Radical Deregulation, Nonfeasance	133
Chapter 12	Strange Connections, Unintended Consequences	149
Chapter 13	Moral Hazard: Why Bailouts Cause Future Problems	161
PART IV	BAILOUT NATION	173
Chapter 14	2008: Suicide by Democracy	175
Chapter 15	The Fall of Bear Stearns	185
Chapter 16	Dot-Com Penis Envy	195
Chapter 17	Year of the Bailout, Part I: The Notorious AIG	203
Chapter 18	The Year of the Bailout, Part II: Too Big to Succeed?	211
<i>Intermezzo</i>	<i>Idiots Fiddle While Rome Burns</i>	226
PART V	POST-BAILOUT NATION	229
Chapter 19	Casting Blame	231



Chapter 20	Misplaced Fault	251
Chapter 21	The Virtues of Foreclosure	263
Chapter 22	Casino Capitalism	273
Postscript	Advice to a New President	287
Notes		297
Index		315