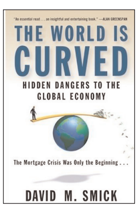
A Global Muddle

By Susan Webber



The World Is Curved
Hidden Dangers to The Global Economy
By David M. Smick
Portfolio, $26.95

David Smick's book represents a remarkable achievement: If readers were to take it seriously, they could wind up less well-informed than before they started.

The title implies a more nuanced take on Thomas Friedman's world-is-flat theory, and the jacket flap promises "an insider's tour through the private offices of central bankers, finance ministers, even prime ministers" to reveal "how today's risky environment came to be—and why the mortgage mess is a symptom of potentially far more devastating trouble." (I apologize for resorting to the book's promotional materials, but Smick's argument is so hazy that it's hard to sum up what he's aiming to accomplish.)

The word "insider" is certainly accurate—as *US News & World Report* notes, "Big financial institutions pay David Smick a lot of money to find out what issues are on the minds of Washington's policymakers." The book, though, presents the author as "one of the most insightful financial market strategists in the world," and that's more problematic. Smick, who edits and publishes the quarterly *The International Economy*, may be a D.C. player, but his grasp of finance is another matter. The author reveals himself to be doctrinaire, slipshod, and either intellectually dishonest or ill-informed.

For the knowledgeable reader, the overwhelming number of errors and omissions constitute a fatal distraction: It's tough to look past all the stumbles to find larger themes in *The World Is Curved*. What comes through is surprisingly retrograde—pro-free-trade, pro-globalization, pro-markets, pro-United States—and ahistorical.

Granted, Smick admits to having trouble getting "my arms around globalization," and it shows. His premise is unprovable: that "the integration of the world's financial markets over the last quarter century has led to a golden era of wealth creation and poverty reduction." Of course, it's impossible to isolate the effect of financial-market integration versus that of demographic growth, improvements in productivity due to technology, more open trade, or the absence of major wars. And the book's agglomeration of chapters, for the most part, fail to bolster its author's contention.

Despite his enthusiasm for the markets, Smick is disturbed by his inability to map them: "[F]or the financial markets, the world is curved. We can't see over the horizon," he pronounces. "We are always being surprised, and that is why the world is such a dangerous place." This is breathtaking. Smick claims to have advised big-money players for over twenty years, yet only now, in this global environment, does he appreciate the nature of market risk. *All human enterprises are unruly and uncertain*. How could anyone with an iota of experience—or even an awareness that the thwarted desire to foresee the future is a fundamental element of the human condition—fail to appreciate that? And markets' tendency toward extreme price moves are well-documented.

Similarly, Smick's readings of recent crises are wide of the mark—not to mention skewed by a nearly pathological hatred of government. He fails to

How the Wise Decide
The Lessons of 21 Extraordinary Leaders
By Bryn Zeckhauser and Aaron Sandoski
Crown Business, $24.95

It's all about making decisions—that's what leadership is about, and what separates the good from the great. And Zeckhauser and Sandoski are owed a debt of thanks for undertaking this book, in which they "sat down with some of the world's most talented and experienced leaders to understand how they make decisions." The authors collected stories, then identified common themes and extracted half a dozen "universal and timeless" principles to follow.

The principles themselves are pretty basic, but the examples and anecdotes, colorful and memorable, drive them home. The authors name names throughout the book, and some names they are—current and former CEOs, a Supreme Court justice, a Nobel economist, and a country's prime minister.

The neat trick is that the examples actually represent good decisions rather than gambles that happened to pay off—and even with the benefit of hindsight, they're not necessarily easy calls. OK, sure, Bill George made the right move in venturing into emergency rooms to see Medtronic's products in action, but what about Sealed Air CEO Dermot Dunphy's decision to hire only salespeople with no experience in the packaging field? Or Baxter Healthcare CEO Vernon Loucks' move to spin off its fast-growing (but sales-cannibalizing) Caremark subsidiary?

Dangerous Business
The Risks of Globalization For America
By Pat Choate
Knopf, $25.95

When it comes to the U.S. economy, Choate has long taken the side of beleaguered taxpayers in excoriating forces that subvert and pervert the way

mention program trading as a significant factor in the 1987 crash, when the Brady Commission and numerous experts placed the automated-selling strategy front and center. Instead, Smick—who regularly digresses to rant about some hypothetical folly that legislators might implement—fingers possible government actions as the primary cause. This despite the fact that the U.S. stock market had exhibited a parabolic run-up. Yes, interest-rate worries and a possible tax on highly leveraged transactions provided a trigger, but the market was primed for a retrenchment.

Likewise, according to Smick, the market dip of August 2007 came out of the blue—even though any *Financial Times* reader knows that reckless lending had become commonplace well before last year, in not just subprime but commercial real estate, structured credits, and LBOs. Similarly, the *FT* reported a dramatic change in credit-market sentiment last June and evaporating liquidity and rising panic in late July. Stock-market declines inevitably follow credit-market slumps within a few months. But Smick, who styles himself an expert, calls the markets "paranoid," insisting that panicky investors drive down prices irrationally. There's nothing irrational about the housing-caused dip: Many of the underlying loans were lousy, and the ever-escalating losses have inflicted massive damage on bank balance sheets. In retrospect, it was the complacency, and not the correction, that was misguided.

Smick, who tends to be long on anecdote and gratuitous name-dropping and short on data, waxes eloquent about the prosperity brought by trade (but tellingly fails to mention stagnant U.S. worker wages since the mid-1970s and lower growth in the last twenty-five years than in the earlier postwar period). But more favorable correlations—the increase in stock-market prices, job creation—are treated as causal. Worse, he cites data by trade booster Gary Hufbauer of the Peterson Institute, who claims that the gains to U.S. GDP from more open trade are 10 percent annually of GDP. How can that be when the entire trade sector is less than 15 percent of GDP? (More reasonable calculations suggest that full trade liberalization would add less than 1 percent.)

Yet Smick permits no middle ground—you are either for "free trade" or an economically illiterate protectionist—even though a host of mainstream economists, from Paul Samuelson and Paul Krugman to Alan Blinder and Larry Summers, are questioning globalization's benefits. Indeed, the author acknowledges and is troubled by the fact that banking crises have plagued the last twenty-five years of supposed prosperity. (Again, these disruptions shouldn't be a revelation: Economists Kenneth Rogoff and Carmen Reinhart's research into the last nine centuries of financial crises found that they are not only the norm but are far more common when international capital flows are large.) This highlights a fundamental muddle in *The World Is Curved*: Smick extols a system that is chronically prone to breakdown. Now, trade may still produce the benefits its backers claim. But the fact that advocates often rely on less than full and fair analyses suggests the critics may have a point.

Indeed, cherry-picking and distortion are pervasive here. For instance, Smick writes, "Since the 1980s, the international financial system has developed new risk-management techniques and a host of new financial wizardry with the goal of making capital less expensive and more available to the entrepreneur." Please. Helping entrepreneurs is the furthest thing from the new-product mavens' minds. And with good reason: Venture capital is as close as high finance gets to entrepreneurs. Amar Bhide, in his landmark study on entrepreneurship, concluded that venture

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capital accounts for a mere 1 percent of new business funding. Savings, family, friends, and credit cards are the main sources of capital. And Smick claims that trade has raised living standards around the world and moved a record number of people out of poverty, though, as Nobel laureate and former World Bank chief economist Joseph Stiglitz points out, poverty has increased from 36 percent of the world's population in 1981 to 40 percent today.

Even more remarkably and inconsistently, in his last chapter Smick rants about how Wall Street greed led to our current financial mess, but he focuses only on off-balance-sheet vehicles (outlawed, in post-Enron reforms, by the Congress Smick so despises). He conveniently overlooks the fact, as *The Bankers* author Martin Mayer recently noted, that "a lot of what is called innovative is simply a way to find new technology to do what has been forbidden with the old technology."

Where Smick isn't wrong or overreaching, he is pedestrian. He tells us, for instance, that hedge-fund managers are eccentric control freaks and private-equity managers are greedy. Who'd've thunk it? He acts as though it is breaking news that President Clinton supported free trade. Capital comes to the United States, he writes, due to the great investment opportunities; maybe it's the result of our yawning trade deficits and our well-regulated markets with good disclosure (at least up to the era of structured credits).

Perhaps most disconcerting for the reader is the nagging suspicion that Smick's oft-stated assumption—that the progress of globalization is beneficial and interfering with it would be a huge error—is faulty. The seeming prosperity of globalization may be due to an unsustainable level of borrowing. The ratio of U.S. debt to GDP has risen to an unprecedented 350 percent, versus 260 percent at the worst of the Depression, higher than in Japan during its bubble years.

Economist Thomas Palley offers an alternate reading: He notes that the period since 1980 has featured large trade deficits, loss of manufacturing jobs, growing levels of debt to income, and wages failing to reflect productivity gains. The appearance of prosperity results from cheap imports and leverage-fueled asset price inflation, and Palley warns that those factors appear exhausted. Indeed, even mainstream economists worry that our trade partners will tire of funding our current account deficit as more and more is interest on past borrowings, as opposed to funding current imports.

Palley may or may not be right, but his line of thinking highlights much that is wrong with *The World Is Curved*. It is bizarrely backward-looking. There is almost no acknowledgement of the seriousness of our financial troubles, and repeated praise for U.S. competitiveness despite the ongoing socialization of losses on Wall Street. Smick insists that the United States must remain the leader of international political processes, arguing that China will fall back. Yet he cannot see the internal contradiction in his argument: The rapid growth in developing countries, which the author touts as a benefit, will inevitably lead to a diminished U.S. role, an outcome he contends would be disastrous.

We need to learn to live in a multilateral world, one in which the United States no longer rules international organizations like the IMF and World Bank. That would have been worth Smick getting his mind around, but it seems too threatening to his worldview.

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it's supposed to work. Here he turns his attention to globalization and pulls no punches: "The globalization policies of Presidents George H.W. Bush, Bill Clinton, and George W. Bush collectively constitute the worst economic policy mistake in American history," allowing "leaders of transnational companies and global finance to enrich themselves and advance their interests at the expense of the larger society."

Bemoaning the "headlong rush into globalization," Choate depicts "a corporately governed nation" in which citizens "face an increasingly bleak future." He highlights risks and dangers to consumers and citizens in micro ways (e.g., tainted pet food) as well as macro ways, most of which involve China. Many of Choate's more scathing observations and pronouncements aren't all that fresh ("Simply put, policy in Washington is for sale"), but that hardly lessens their pertinence.

Granted, at times Choate finds his environment a little too target-rich—yes, the Bush administration has been unreasonably secretive when it comes to classifying documents, but raising the issue distracts from rather than bolsters the arguments. He's on firmer ground decrying "the surrender of U.S. sovereignty to international bodies such as the WTO."

As with every book that takes on issues this sweeping, Choate is better at raising questions than at answering them. But intriguingly, he calls for "a small, high-level corps" of citizens "to staff and administer the federal government's major programs"; the only requirement would be a commitment to not cash in later. And equally astute—albeit just as unlikely—is his urging of the "next U.S. president to work with his or her counterparts in Europe, Japan, and China to negotiate a global code of corporate 'rules of the game.'" Indeed, Choate's solutions lean heavily on a political savior: a president with "the wisdom to understand the challenges and risks created by globalization, plus the character and political skills to overcome them." A tall order, to say the least. —MATTHEW BUDMAN