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THE WALL STREET JOURNAL.
WSJ.com

BOOKS | SEPTEMBER 19, 2008
BOOKSHELF

The Woe on Wall Street

By TODD G. BUCHHOLZ

Columnist Thomas Friedman keeps telling us that the world is flat. Well, the world of Wall Street sure got flattened this week -- that is, steamrollered like Wile E. Coyote. Now comes David Smick to argue for a curvaceous Earth, where globalization raises tempers and volatility, not just income. In "The World Is Curved," Mr. Smick warns -- with prescience, as it turns out -- that financial disaster lurks just beyond the horizon, thanks to reckless investment banks, rash hedge funds, fraudulent Chinese bankers and American voters who are learning to hate the taste of free trade. Mr. Smick's book arrives just in time to give you that final nudge out onto the ledge.

Mr. Smick, a Washington consultant, neatly spells out both the upsides and downsides of economic liberalization: the hundreds of millions of people lifted from poverty as well as the middle-class workers struggling to keep their jobs amid ferocious competition. Overall he gives two cheers for global capitalism, offering a quote from Kofi Annan that must have staggered many of the former U.N. secretary- general's fans: "The main losers in today's very unequal world are not those who are too much exposed to globalization. They are those who have been left out."

But Mr. Smick is hardly a flat-Earther of the Friedman stripe. He attacks the pernicious leverage practices of the past decade and describes how hypocritical banks slashed hedge-fund lending after Long-Term Capital Management nearly blew up the world in 1998 but then juiced up their own leverage. How did they do this? How did they escape the restraints of the Basel capital standards adopted to ensure global financial stability in the wake of the LTCM debacle? By shunting risky positions to new, separate entities. In other words, Wall Street has been torching itself of late because banks thought they could avoid scrutiny by writing down their risky bets on a *completely separate piece of paper!*

The real problem running throughout the system was not a lack of new regulations. It was a lack of skin -- that is, skin in the game. Mortgage brokers turned into fly-by-nighters, immune from the effects of reckless decisions. Local bankers securitized loans and packed them off to some naïve investor or to a rating agency manned by analysts who weren't sharp enough to get a job at Bear Stearns or Lehman. Homebuyers who put nothing down or lied about their income could pack up and run off, leaving no skin behind. The entire housing sector began to look like a motel renting rooms by the hour, as johns and hookers snuck out during the wee hours. Where were the regulators? Where was Eliot Spitzer? (Maybe we know the answer to that one.)

Was it all a mirage? Was the fabulous economic growth of the 1980s and 1990s, including the tenfold rise in equity markets, just a series of hot checks changing hands? Mr. Smick does a fine job of illustrating the pace of change. In the 1960s and 1970s, only 20 firms dropped off the Fortune 500 list per year. Between 1990 and 1995, 200 firms went *poof*. Just this week we've lost a few more. Still, the boom was real. While the U.S. created about 40 million net new jobs in the 1980s and 1990s, Europe created 40. Not 40 million. Just 40, a few dozen. Whole industries in computing and telecommunications rose up in the U.S. from the imaginations of geniuses as well as from the garages of tinkerers. Net worth soared, and the U.S. jobless rate plunged, snickering at the Keynesians who worried about the "natural rate of unemployment."

Today we are, of course, paying back for outrageous over-leverage in recent years, but it doesn't look as though we will substantially surrender our general standard of living. Wall Street might be a muddy mess, but Main Street is actually holding up rather well. Mr. Smick likens the global financial market to a "rich, generous, but occasionally deeply paranoid great-uncle" who can suddenly cut off the money spigot. That uncle has never been more paranoid or ornery than he is today.

Mr. Smick has dined with a great many rich, powerful and ornery people. The blurb pages bulge with just about anyone who has ever signed the paper money of any country you've ever heard of. Hans Tietmeyer loved the book! Alan Greenspan's endorsement shows up on the cover -- and he often shows up inside, too. Mr. Smick relates how, as Federal Reserve chairman, Mr. Greenspan would try to impress and confound his colleagues by citing obscure data points -- or challenging others to come up with them. At one Fed meeting, Mr. Greenspan suddenly asked: "Does anyone know the latest price of tomatoes?" The chairman was hungry for status, not a BLT. Mr. Smick recalls regular breakfasts with Mr. Greenspan but admits that the Fed chairman "never offered any useful information about his monetary policy goals." As a former economic adviser to President George H.W. Bush, I can tell you that the president never got anything out of the man, either.

In its later chapters, "The World Is Curved" focuses on class warfare and fears that U.S. trade policy may retreat into a protectionist cave. In the 2008 Democratic primaries, for example, Sens. Barack Obama and Hillary Clinton threatened to rewrite or rip up the North American Free Trade Agreement. And

Mr. Smick frets over demagogues flaying the wealthy and bemoaning unequal income distribution. With Lehman Brothers employees, like Bears Stearns employees before them, lugging cardboard boxes out of dimmed offices, there will be fewer Bentleys rolling around town and riling the masses. That's one problem solved. Alas, the only one so far.

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