FROM THE

FOUNDER

The Smartest Guys In the Room

I remember the moment as if it happened yesterday. The scene: the Dolder Grand Hotel, high in the hills above Zürich, Switzerland. It was 1986. I was the co-organizer of an important international monetary conference there dubbed "The U.S. Congressional Summit." On the agenda: the dollar, trade, and debt. Many finance ministry and central bank officials from the then–G-5 nations were in attendance.

Moments before the start of the conference, one of the sponsors, U.S. Senator Bill Bradley (D-NJ), and his staff approached me with a question. The senator had decided to offer a formal statement, but wanted me to be aware of its provocative nature and to ask my opinion. The subject of the statement: the need for immediate debt relief in the context of a growth agenda for what was then called the Third World.

My response to the senator: "Why not? Isn't this precisely what private conferences are for? To discuss provocative issues deemed too unsettling for the official discussions."

Senator Bradley's remarks proved to be explosive. This was the pre-cellphone era, so dozens of reporters ran for the pay phones. "Bradley's moving markets," one Reuters wag hissed frantically to me, phone receiver in hand. The senator had planted a powerful seed.

But here's the part of the story that's most interesting. I received a tongue-lashing for the senator's comments. Within moments, I found myself cornered in the hotel lobby by the U.S. Treasury officials in attendance. "This is highly irresponsible!" one shouted. A more junior official added: "How could you allow Bradley to make such a statement? This is dangerous. You're playing with fire."

Senator Bradley's remarks proved to be explosive.

My response: "U.S. senators don't ask for permission to offer their views. Besides, the Third World desperately needs a growth agenda. Nothing dangerous about that."

Senator Bradley's call for debt relief proved prophetic. Less than three years later, Brady Bonds, a

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

market-oriented tool of debt haircuts, were being celebrated as part of an emerging market growth strategy.

Years later, after former U.S. Treasury Secretary Nicholas Brady (who was not yet in office at the time of Senator Bradley's prophetic Switzerland bombshell) left office, he graciously invited me to his retirement dinner at a downtown Washington restaurant. To my surprise, the same Treasury officials furious at Senator Bradley's "irresponsible" Switzerland remarks years before were the most vociferous in touting the success of Brady Bonds. Which goes to show that in economics and finance, even the smartest guys in the room can miss the call.

This is also what happened in the period leading up to the 2008 Great Financial Crisis. The smartest guys blew the call. They failed to see that the world's big banks had little understanding of the risky "trust me" paper financial assets on their balance sheets. As happened earlier with emerging market debt, a tectonic shift had occurred. The landscape had changed. The experts hadn't a clue.

Today the big thinkers are debating whether a growth strategy for Greece (if not the entire eurozone periphery) should entail further debt relief, this time from public creditors (see "Does Europe Need Debt Relief?" on page 9). But here's the thing: Are the smartest guys missing an even more important picture? The entire world's public and private debt, depending on the means of measurement, now exceeds a whopping $180 trillion. What's the significance of this massive debt? Is it sustainable? Is it one reason for the world's subpar growth? Nobody knows.

If a global deflation scenario unfolds, the level of the world's real debt will grow to the point where massive rolling defaults could become a terrifying fact of life. In an aggressive inflation scenario, on the other hand, the debt's value in real terms will shrink, but at a brutal cost to the livelihoods of working families if not to capitalism itself.

The obvious solution is to control the growth of future debt while encouraging a global explosion in innovation and productivity growth. This is what the British did in dealing with their horrendous debt after the Napoleonic Wars. In an environment of record-low global interest rates, in which a lot of economic activity has been moved forward, an explosion in innovation and higher productivity growth may be the only safe way eventually out of today's low interest rate trap. But an explosion in innovation that leads to higher global growth entails the issue of human motivation. People have to believe the future will be better than the past. That's not the case today.

Yet in the period since the 2008 crisis, the smartest guys have consistently argued that money is the driver of human behavior. In response to the crisis, for example, the world's governments and central banks bet the farm on a giant money-driven rescue operation the size of which the world had never before seen. More than $17 trillion, or 25 percent of global GDP, went for stimulus, bailouts, and guarantees. The result: After an initial sugar rush of economic activity, global growth, trade, and cross-border financing since 2010 have all plummeted. Today's slow-growth environment is helping spawn a geopolitical nightmare.

Are the smartest guys missing an even more important picture?

It turns out the massive flood of money failed to drive human behavior, at least to a level expected by historic standards. The lesson here is that money is just a measuring tool. As Adam Davidson wrote in the *New York Times,* "What actually matters is what we make and do and feel and want." Stated in short: In achieving higher levels of economic growth, attitude matters. Record low interest rates and generous fiscal stimulus are meaningless if people have no confidence in the future.

So where does this all end? The world faces a troubling nexus of unprecedented debt, record low interest rates, exploding central bank balance sheets, declining growth, worldwide asset prices that may or may not reflect true value because the policymakers have their thumbs pressing down on the scale, a global currency war against the dollar as dollar-denominated debt is approaching $15 trillion, all at a time when polls consistently show people believe their children's future is in jeopardy. Does anybody know the end game to this bewildering scenario? Or should we get the smart guys on the line?

—DAVID M. SMICK
Founder and editor, TIE, *and author of* The World Is Curved: Hidden Dangers to the Global Economy