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Home Site Index Site Search Forums Archives Marketplace

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ARCHIVES
- ABOUT THIS SERVICE
- MY QPASS
- ARCHIVES HELP

Keeping the Boom From Busting

By Jacob Weisberg

Only a few years ago, Japan was regarded as America's most dangerous economic rival. But during the third week of June, as Treasury Secretary Robert Rubin pondered the question of how to coax that country back in from the ledge, no one was yelling for Japan to jump. The debate was about whether we could help the sagging Japanese economy by intervening to support the yen, or by stepping back as it continued to slide.

Foreign-exchange traders, who make it their business to know what Rubin thinks, had every reason to think he was not going to move to support the yen. In Senate testimony earlier in June, he underscored his familiar argument that without financial reform in Japan, intervening to prop up the yen could have only a temporary effect. Rubin made this point again to reporters on June 16: only the Japanese could rescue their faltering economy, which shrank at an annual rate of 5.3 percent in the first quarter of this year. That same day, Rubin joined a conference call composed of Clinton Administration officials who had been dealing with Asia's economic crisis since shortly after it began, following the collapse of Thailand's currency, in July of last year. He fretted that even Clinton's plan to phone the Japanese Prime Minister, Ryutaro Hashimoto, that evening to encourage him to fix his country's troubled banking sector could prove counterproductive. Rubin was worried that Clinton would end up sympathizing with Hashimoto's political plight instead of pressing him to act.

In an Oval Office meeting a few hours later, Rubin hung back and remained quiet, as he often does when faced with an array of bad choices. When Clinton asked what he should do about the yen, which had fallen as low as 147 to the dollar, Rubin repeated that intervention by itself wouldn't do much good. After the meeting, he walked back across the courtyard that separates the White House from the Treasury. There, in the office of Deputy Treasury Secretary Lawrence Summers, he joined a discussion in progress among the tight-knit circle of advisers who constitute his brain trust.

Although he meant what he said about the limited value of intervention without reform in Japan, Rubin is someone who loves to examine and re-examine his options -- a tendency the academically minded Summers refers to as "his preference for optionality." As he sat down, Rubin told his advisers he was tired. In post-cold-war Washington, and especially since the beginning of the long boom that has marked the Clinton years, the Treasury Department has come to be perceived as a venue for crucial decision-making in international affairs; for Administration insiders today, something as recondite as a currency intervention can bring about the political drama -- and the sleepless nights -- once reserved for decisions about whether to stick with a third-world anti-Communist dictator.

Rubin, Alan Greenspan (the Federal Reserve chairman) and the aides gathered in Summers's office had been going back and forth about the yen for four days. An argument against action was the risk of damaging American credibility by intervening unsuccessfully, something Rubin worries about constantly. But continuing to prod the Japanese without intervening seemed just as dangerous. The Japanese Government lacked the political will to face its economic problems, the most serious of which is a banking crisis that is, in essence, a version of America's savings-and-loan crisis of the 80's, only much larger in scale, with an estimated $600 billion in bad loans. Inaction on the part of Japan was deepening the country's recession and undermining chances for a comeback in the rest of Asia.

If the yen continued to fall, it could prompt Korea and Indonesia to devalue their currencies again; there was the danger, too, that China might devalue its yuan. Taken together, such devaluations could set in motion the worst bout of a contagion that has already reached as far as Moscow. And another round of plunging currencies, especially if accompanied by a Japanese bank panic, could send U.S. markets into a tailspin. Because of these concerns, among others, two aides whose views Rubin respects most -- Summers and Timothy Geithner, an Assistant Secretary of the Treasury -- were now both in favor of acting, arguing that it could help prod Japan toward reform. The next day, Japan's legislature, the Diet, was going to vote on the country's budget. Afterwards, politicians would make public statements. "I had not realized that the Diet was going to have its final session on the budget," Rubin says, "and that added a little bit of weight." He now saw the intervention as part of a package that included a trip by Summers to Tokyo and public statements that Japanese elected officials would make about reform. Though Rubin predicted that the yen intervention would prop up the currency only temporarily, he was persuaded that, taken in sum, these actions stood to increase the probability that the Japanese Government would budge and move ahead with reform.

At about 9:30, Rubin told his assembled aides, "I think we probably ought to do it." He then scanned the room and said that anyone who disagreed strongly should speak up. No one did. Later that evening, he phoned Clinton from the Jefferson Hotel -- Rubin lives there during the week, just blocks from the Treasury and the White House -- to prep him for his call to Hashimoto. When markets opened the next morning, the Federal Reserve Bank of New York converted an estimated $2 billion into yen, catching foreign-exchange traders napping and driving the rate back up to 136 to the dollar.

In the following weeks, Rubin's analysis was at least partly vindicated. Though the yen resumed its slide, as predicted, Japan did go some way toward answering global demands for action to revive its economy with a plan to clear up the hundreds of billions of dollars in bad loans. Rubin remarked to aides afterward that the decision was one of the most difficult he had faced as Treasury Secretary. But a week later, on the phone from China, where he was accompanying the President, he was philosophical. "This is the kind of uncertainty I used to live with all the time," he said, referring to his days as a trader at Goldman, Sachs, Wall Street's most storied investment firm. "In the final analysis you just live with all the pros and cons. These are all imperfect choices. You decide which one seems best."

The yen intervention was more than a marker of Japan's humbling. It signified a moment in our own politics in which the defense of prosperity became an overwhelming national preoccupation. With the recovery now in its seventh year, almost everyone in the United States has felt its effects. Our unemployment rate is -- incredibly -- nearly as low as Japan's. Working wages, stagnant through much of the past decade, appear to be on the rise again. Inflation is a memory, and the long bull market has left the swelling ranks of shareholders feeling flush. We live in anxiety, however, that these happy conditions may come to an abrupt end. Though the U.S. economy appears remarkably robust, the potential threats to it are many and diffuse. Growth that is too rapid might ignite inflation; cash flight into the U.S. could pump more air into a market bubble, and bubbles burst; or a currency crisis ricocheting out of some country most Americans couldn't find on a map might bring on a worldwide slump.

Ours is an uneasy opulence, which looks expectantly to those who seem able to comprehend obscure threats and ward them off. A few years ago it was Greenspan, maestro of the money supply, who was viewed as the recovery's essential man. But of late it is Rubin. If he looks exhausted these days, it may be less from five and a half years of commuting between New York and Washington than from the strain of playing Atlas to the world economy -- carrying a globe that constantly threatens to spin out of control.

This is an unexpected position both for the Clinton Administration and the man sometimes described as its second most important member. Clinton never expected to be remembered as the President who tickled the stock market pink. He came to Washington with a set of ideas about assisting the middle class through innovative programs like managed-competition health-care reform and voucher-based worker training. Rubin, though his own concern has always been focused more on the poor than the middle class, shared Clinton's notion of a reform liberal activism. He gave up the chairmanship of Goldman, Sachs and joined the Clinton Administration as chairman of the National Economic Council in hopes of playing a part in helping the inner cities and the public education system.

To the frustration of its more populist-minded members, the Administration never got a crack at deploying most of Clinton's ideas. But along the way, Clinton found himself the beneficiary of a growth spurt that has done more for the poor and middle class alike than all his unhatched programs could ever have done. A factor in this spurt was Clinton's decision to close the budget deficit -- a strategy promoted by Rubin. For many of the original Clintonites, Rubin's success in economic policy is bittersweet. "Bob has done an able job keeping Wall Street happy and confident," says Robert Reich, the former Labor Secretary. "And in today's world, their confidence is critically important to the success of the economy. But is it necessary to accept a world in which Wall Street has that much influence over both economics and politics?"

The last five years haven't played out as Rubin anticipated, either. He has done his utmost to resist Wall Street's dictates on a number of issues, including the capital-gains tax cut and the notion of reforming Social Security through privatization. He still cherishes hopes of a renewed bout of domestic activism finally made possible by an era of surplus. But in the autumn of his government service, Rubin surely realizes that his own legacy will be in the economic sphere. His move from Wall Street to Washington has turned out to be less of a departure than expected.

Of course, there is the question of whether Rubin really is an important factor in the 90's boom. Most economists who have considered the question agree that the power of any President and his team to create prosperity is marginal. To many economists, and to most conservatives in Congress, Rubin is like the President he works for, the undeserving beneficiary of an amazing run of luck.

And Bob Rubin is indisputably a lucky man. Before he came to Washington, he made a fortune, which has grown to more than $100 million, at Goldman, Sachs. (Though he would be in line for several times that if he'd stayed.) At 59, he is happily married, admired by his colleagues and blessed with an economy that can't stop cooperating. Even the Asia crisis may end up going his way: if successfully contained, it may provide a well-timed correction to an overvalued stock market.

Rubin himself is both too modest and too given to nuance to take much credit for the performance of the economy. "It's a combination of a lot of factors," he told me over lunch in New York last month. "It's some things we've done, some things other people have done, what the private sector has done. It's good fortune. It's all this coming together, plus some elements I'm sure that no one recognizes today. Economic historians 25 or 30 years from now will identify factors you can't see sitting where we're sitting." And to the extent the Administration has fostered favorable conditions, he insists it is the President, not he, who is responsible.

But even if he declines his bow, there is a case for giving Rubin a considerable share of credit. The Treasury Secretary's sang-froid in moments of crisis, his intense thoughtfulness and his instinct for how markets behave aren't merely coincidental to the boom. There are fund managers on Wall Street who say the Dow could easily drop 1,000 points the day that Rubin announces he's moving back to Park Avenue. You might call this the Rubin premium -- the amount investors pay for the security of having him where he is. It's too crude to say that Bob Rubin made the boom. But despite numerous threats, it has yet to go bust, and Rubin's calculations have played no small part in that.

Rubin began thinking about the interplay of luck and skill as a student of economics at Harvard in the late 1950's, and continued to ponder it at the London School of Economics and at Yale Law School, where he finished in 1964. It was during these years, he says, that he learned to think about life "probabilistically." That is, Rubin came to believe that while no one can predict the future, it is possible to assess the odds of various futures. "At Harvard and Yale Law School I learned to think about the uncertainties and the ambiguities of life intellectually," he says. "When I got to Goldman, Sachs, I learned it was a matter of financial life and death to learn to be probabilistic. If you thought in absolutes and black-and-whites, sooner or later you got wiped out. The odds would catch up with you."

He didn't start at Goldman, Sachs. After graduating from law school, he went to work for the New York firm of Cleary, Gottlieb, Steen & Hamilton, where he did securities work. Before long, though, he decided that the dealmakers across the table had a more interesting job than he did. He began sending out resumes. Around the same time, L. Jay Tenenbaum, who was running Goldman's arbitrage trading desk, got Rubin's name from a mutual friend. Rubin was close to accepting an offer from Lazard Freres, but Tenenbaum changed Rubin's mind.

Tenenbaum's chief selling point was that at Goldman, Rubin would be working for Gustave Levy. Described by The Times when he died in 1976 as the best-known man on Wall Street, Levy is still remembered with a combination of affection, terror and awe. Born in New Orleans, he showed up on Wall Street in 1928 when his widowed mother could no longer pay his college tuition. As Levy often told the story, he moved into the 92d Street Y with $2 in his pocket, and got a job as a runner at a brokerage firm. In 1933 he went to Goldman, Sachs as a bond trader, and soon became an arbitrageur, eking out gains on price differentials among world markets.

After Levy returned from the Second World War, the old kind of arbitrage, which depended on the ability to communicate between unconnected markets, gave way to "risk arbitrage," a field he helped to invent. After the war, railroads that had gone bust during the Depression emerged whole. Arbitrageurs would follow reorganization proceedings and buy up bonds that had been in default. This developed into a technique for speculating on a wide variety of corporate bankruptcies, breakups and mergers.

Levy was brilliant at this work, and hard on those less capable. "His technique for management," Rubin recalls, "was yelling." In the days when he ran the arbitrage desk, he would regularly fire all his assistants. The traders knew to show up for work the following day. Despite his temper, he was an immensely gifted financier. As Rubin says, Levy virtually invented the modern equity-trading room -- and kept a close eye on it through a glass partition at the office at 55 Broad Street after becoming Goldman's chairman in 1969. Superstitious by nature, he described his success as "a miracle." According to Tenenbaum, Levy lugged around so many lucky coins in his pockets that they dragged his pants down off his hips. "I'd rather be lucky than smart," he used to say, when an investment turned out well for unexpected reasons.

Levy and Rubin could hardly have been more different. The gruff chairman could usually be found puffing a big cigar at his desk by 8 A.M. and liked to toss back three or four martinis at 21 after work. Rubin is a wiry ascetic who prefers carrot sticks, Perrier and Trident sugarless gum. Levy would yell and curse, second-guessing traders who lost money in a deal. Rubin, by comparison, is almost impassive and reins in errant subordinates by asking pointed questions. According to a former partner, you could walk by the arbitrage desk at Goldman and not gather from his expression whether Rubin had just made a killing or lost his shirt.

Nonetheless, there was a powerful bond between Levy and Rubin. Most of all, Levy loved Rubin because of his competence. After a short time on the arbitrage desk, Rubin was allowed to take charge of getting Goldman into the business of trading options and later into commodities. Such farsightedness propelled Rubin upward, making him a partner after just four years at Goldman, the fastest such rise in the firm's history.

Though he later turned his hand to foreign currency and bond trading, Rubin's greatest knack remained arbitrage. "I would say that he had a surprising tolerance of taking a risk," Tenenbaum says. "Bob's demeanor always exuded tremendous conservatism. On the other hand, when it came to a risk situation, he would surprise me. 'Why don't we do that? Let me take a chance.' He'd be quite willing. It's sort of paradoxical."

What was paradoxical about Rubin's risk-taking was how reasoned it was. "Arbitrage is an actuarial business, just like so much of life," Rubin says. "Each judgment was probabilistic. What you needed to do was make sure you didn't get so big in one position, even if the odds were very good, that if it went bad it wiped out everything else. You had to maintain your balance."

Put another way, Rubin played arbitrage the way a mathematician plays poker, keeping track of cards and weighing odds so as to reduce the factor of luck. In considering whether to take arbitrage positions, Rubin would muster all available information, constantly recalculate the percentages and make a decision only when necessary. Although a player with this kind of discipline will sometimes lose -- and sometimes lose big -- over time he has a significant advantage over those who behave less rationally. Rubin's returns as head of the arbitrage desk were consistently good, better than 20 percent a year through the market doldrums of the 1970's.

To try to understand how he accomplished this, I paid a visit to Robert Freeman, who sat next to Rubin at the Goldman arbitrage desk for 17 years. Freeman came to grief in the insider-trading scandals, eventually pleading guilty to one count of insider trading in 1989, though he maintains he was not guilty and Rubin says he believes in Freeman's integrity. (Since resigning from Goldman, Freeman trades stocks from an office over the garage at his home in Rye, N.Y.) Freeman recalled for me how he and Rubin made arbitrage calculations by sketching out a rudimentary "expected value" table on a legal pad. This is the arbitrageur's way of evaluating risk against reward. Say the stock of Roadrunner Inc., driven up by merger talks, is trading at $18. If a friendly takeover bid from Acme Industries goes through, the stock will be worth $21. If the bid fails -- if the companies' directors can't get along, or if the Federal Trade Commission blocks the merger -- the stock will most likely drop back to its pre-merger-plans price of $10. To decide if it's worth taking a position, an arbitrageur has to judge the probability of the deal's going though. Let's say he rates the probability at 80 percent.

80 % x + $3 = + $2.40 upside potential

20 % x $8 = $1.60 downside risk

Expected value = + .80

If the expected value is positive, as it is here, an arbitrageur would regard the risk as worth taking. However, the judgments that go into the calculation are complex and can be highly subjective. As Freeman explains, you might include "regret analysis." How bad would you feel about losing your firm's money if the deal failed? This might cause you to double the downside risk to $3.20 and not play.

"Bob was a very good arbitrageur because he was totally objective," Freeman says. "He could step outside and say, Look, I think this deal's going to go through. He didn't personalize." Freeman recalls his own job interview at Goldman in 1970. Rubin was watching a position he had taken in the liquidation of Roan Selection Trust, a company that owned gold mines in Botswana. "There had been a collapse in one of the mines," Freeman recalled. "My interview with Bob Rubin was conducted as he was getting phone calls from Africa. If someone had walked in and seen him, they would have thought nothing was going on. Bob would get a phone call about the mine collapsing and then turn to me and say, What did you major in in college?"

What Rubin still responds to is the elegance of this type of high-pressure decision-making, based on calculations made in his early Wall Street days with a slide rule. He once described this approach to me as trying to function as a kind of "mental yellow pad." The trick, he says, is to separate your emotions from the analysis. It's a bit of Wall Street Zen: don't invest in your investments.

Remaining detached was often no mean feat. For one thing, Rubin, as part of his job, was sometimes gambling with a third of his partners' retirement money. In 1979, for example, he took a number of arbitrage positions that depended on the expectation that inflation and oil prices would continue high. When oil prices and inflation dropped, many of his investments plunged. "We had one month in which we lost more money than the firm made in any prior year," he remembers. "But most people had internalized this sort of thing and the senior management, particularly, was very good about saying, Look we understand once in a while things like this will happen. It doesn't mean people weren't nervous because they were -- hell, I was nervous."

Of course, it would never have shown at the time. Rubin is the type who admits he was a bit rattled only after the bombs had stopped falling -- as they did later that year, when oil prices and inflation resumed their upward trajectory and rescued his positions. This serenity is partly a tribute to temperament and partly a matter of intellectual precision. If Rubin remains cool under pressure, it is because he rests secure in the knowledge that he has done his analysis and minimized his risks.

This is both a personal and a professional style. The effort to reduce uncertainty is visible in everything from the way he dresses -- same dark suit, same white shirt, same black penny loafers every day -- to his Spartan lunches of bottled water and salad without dressing. At dinner at the Jefferson, where he eats most nights, Rubin usually drinks a single glass of well-chosen wine. (One former aide jokes that when he finally checks out of his suite, his bill will be delivered with a forklift.) This does not mean he lacks a wide-ranging curiosity: Rubin shares his wife Judith's interest in the theater -- she was the chief of protocol for Mayor David Dinkins of New York and now sits on the National Council on the Arts -- and loves to browse in bookstores. On the shuttle and on the exercise bicycle in his hotel suite, he finds time to read things that have nothing to do with his work, like Noah Adams's book about learning to play the piano in middle age. But Rubin is a meticulous man who speaks with great care, constantly fine-tuning his utterances and only rarely giving vent to his wry humor. His approach is that if you make sensible judgments, you can improve your odds of success in every aspect of life.

"One of the first times I met with him, he asked me if a bill would make it through Congress, and I said, 'Absolutely,' " a young Treasury aide recalls. "He didn't like that one bit. Now I say the probability is 60 percent -- and we argue about whether it's 59 or 60."

The story of early battles over economic policy within the Clinton Administration has been told before, with Rubin at the center. What has not been well understood is how much the strategy that emerged was the product of Rubin's way of thinking about risk and reward, applied to the biggest bet of his career.

During the 1992 transition, and in the early days of the first Administration, the Clinton team was divided into two camps. On one side were the deficit hawks. On the other were more populist types like Reich who wanted a budget focused on new "investment" -- money for job training and the like. As head of the newly formed National Economic Council, Rubin presided over the debate.

Though he winced at their soak-the-rich rhetoric, Rubin sympathized with the populists and let them make their case to Clinton. But his own pitch to the President, bolstered by the message coming from Greenspan, was that if a credible deficit-reduction plan emerged, the bond market would react favorably, resulting in lower long-term interest rates. This would stimulate the economy, which in turn would boost tax revenues, inducing a "virtuous cycle" and a sustained recovery.

But for the bond-market strategy to work, it had to be credible to Wall Street. Investors had to believe that the new Administration was dead serious about reducing the deficit; its Republican predecessors had offered ambitious promises and then backed away. And even if Wall Street bought his program, Rubin warned Clinton, it might not work as hoped. Markets might react unfavorably, as some Republicans were predicting, causing the economy to contract.

Clinton also had to weigh the social and political costs of holding off on spending money for public investment. As Rubin saw the opportunities and risks, it was not unlike arbitrage. "Nobody ever put it together in quite that way, but it's an expected value table," he says. "The expected value framework is formalizing the way it seems to me you should think about these decisions. It's the same idea without the numbers."

There are, as Rubin says, a multiplicity of factors that have contributed to the boom. But perhaps the establishing act of what will soon qualify as America's longest peacetime expansion was the fact that Rubin's bond-market strategy worked as he forecast.

The story of the Rubin years at Treasury can be summarized as one of trying to anticipate threats to the recovery and head them off at the pass. As always with Rubin, it has been a matter of assessing risks and responding with exactitude and unflappability.

The first calamity was the currency crisis that hit Mexico shortly before Rubin became Treasury Secretary in early 1995. Rubin and his aides worried about a flood of immigrants and about losing the argument for free trade. An additional fear was the so-called tequila effect -- that under a New Domino Theory of global economics, wobbliness would spread through Latin America. Rubin, typically, analyzed the problem as an arbitrage. "I think initially, we felt if we had something that could work, it just seemed so overwhelmingly important to do it -- the risk of not doing it was far greater than the risk of doing it," he says. "Even if you thought the odds got a little bit questionable, the importance of doing it was so great. In an expected-value equation, the downside of it not working and the gains of it working could be so enormous that you would do it anyway."

Lawrence Summers plays a curious role in relation to Rubin on decisions like this. A prodigy who became the youngest full professor of economics in Harvard's history (he was 28), and later the chief economist at the World Bank, he is more brilliant than Rubin, and less restrained. An absent-minded professor, he is always losing his keys or forgetting to tuck in his shirttails. (True to form, when I joined him and Rubin on a trip to London in February for a Group of Seven Finance Ministers meeting, Summers missed the flight because he had left his passport home.) Like Rubin, who hired him as an economic adviser to Goldman, Sachs in the 1980's, Summers is always weighing probabilities. "It's really trying to maximize an expected value keeping in mind the multiplicity of possibilities," Summers says. "That basically is the canonical mode for making rational decisions. People who make job choices well in their lives, people who make personal choices well, are all people who have implicitly made sensible calculations based on the fact that there are a multiplicity of possibilities."

One thing Summers says he has learned from Rubin is the value of not always choosing among the available options. "Rubin ends half the meetings with -- 'So we don't have to make a decision on this today, do we?' Summers says. New information will evolve." In Treasury discussions, Summers's push for an intellectually satisfying conclusion is often buttressed by Rubin's worldly experience. Where Summers understands how markets work in theory, Rubin has a feel for how they react in practice.

With the new Gingrich House disinclined to grant funds for what could be described as a "bailout" of Mexico, Rubin and Summers decided that seeking legislative approval did not maximize expected value. Instead, they put together a package of nearly $40 billion in International Monetary Fund and Treasury loans that could be made without Congressional approval, but tied to stringent conditions. Mexico had to use its oil reserves as collateral and pay interest approaching the market rate.

What is telling about Rubin, and what makes him ultimately such an unusual character in Washington, is how he thinks about something like the Mexican support program in retrospect. He points not to the happy result -- that Mexico paid us back ahead of schedule, with a tidy profit for the Treasury -- but to the sound decision. "If the Mexican support program had gone bad, I would still have said that it was the right thing to do," he says. "But it was judged successful because it worked. I don't think that's actually the way it should have been judged. It should have been judged based on whether it was the right judgment for our national interest in terms of everything that could be known at the time." Rubin says that focusing on the result rather than the decision is what's wrong with Washington, because it deters people from "acting optimally."

Republicans are skeptical of this tone of apoliticism. They think Rubin uses it as a dodge for playing highly political games. Many are still nursing sores from the end of 1995 when he crushed their attempt to coerce Clinton to sign their budget by threatening default on the national debt. Rubin portrayed himself as appalled by this gambit, describing the threat that America would fail to meet its obligations as "unthinkable," and eventually winning an abject surrender.

In fact, Rubin is canny about politics. It is factored into his expected-value calculations as it has been since he was evaluating antitrust threats to mergers. He treats politics as a consideration in policy-making, but not as an overriding one. As friends note, he is truly chagrined when political considerations overwhelm sound decisions. One recent example was Rubin's objection to sweeping reform of the Internal Revenue Service, on which he eventually had to yield ground. Another, on which he has not yet surrendered, is his obstinate stance against a tax cut cast as an end to the "marriage penalty." Rubin even feels this way even about politics in other countries. Talking to him about Japan, you sense his dismay that the country's leaders are unwilling to take the risks necessary to reverse their country's economic decline -- the sorts of risks he thinks the Clinton Administration took with its economic strategy and then with Mexico.

By the time the Asian crisis hit last year, Rubin had already been thinking about potential problems in the region for some time. He raised concerns about the "frothiness" in Asian markets as early as April 1997. Capital was pouring in and he wondered whether foreign investors were discounting the "risk premium." But no one, Rubin included, was prepared for the consequences when Thailand, as Tim Geithner puts it, "fell of the cliff."

This time, Rubin had less discretion. After Mexico, Senator Alfonse D'Amato added an amendment to an appropriations bill that put conditions on Treasury's lending money without Congressional approval. Rubin could have gone to Congress. But he and Summers and Greenspan discussed it at one of their weekly breakfasts and agreed that it wasn't a good idea to commit American capital. While the danger of an Asian contagion was real, there was a risk of accentuating the "moral hazard," by saving investors from the consequences of their choices.

Rubin's response to any international crisis begins from a kind of Treasury Department corollary of the Powell Doctrine: If the U.S. cannot act decisively, we should not put our resources and credibility on the line. As Summers puts it, Rubin's consistent approach to the crisis has been "that there is something worse than Country X going down, which is Country X going down and taking our credibility and $10 billion of our money with it."

Those around Rubin point admiringly to the way he arrives at such a decision. He begins by gathering all the information he can, toting reams of reports and articles around in a pair of giveaway vinyl briefcases he picked up at a Finance Ministers' meeting in Japan a few years ago. He often reaches down several levels in the bureaucracy to find the person most knowledgeable about the problem at hand, which Treasury officials say his predecessor, Lloyd Bentsen, never did. Being nonhierarchical is something Rubin learned at Goldman, where senior partners trust junior ones to manage their money. He loves to ask questions and embodies the adage, which he sometimes repeats, that you learn more from listening than from talking.

"What so many people have a tendency to do is to lock into a scenario," Summers says. "What Rubin will say, at times to the frustration of others, is that some questions don't have answers -- which is to say that just because a problem is terrible, we don't have to act. It may not be the right time."

When an I.M.F. support program failed to take hold in Thailand, the upside

value of involvement and the risks of not intervening increased. In September, Indonesia, Malaysia and the Philippines began to suffer currency and market declines. Rubin and his team worried that markets for U.S. exports would turn into cut-rate exporters of goods to the U.S., harming the economy and setting back the consensus in favor of free trade. They also feared a contagion beyond Asia. "You had Brazil close enough to the edge that they could have gone, and that would have created a greater risk that Mexico and Argentina would have gone," Geithner says. "And Russia, and everybody else."

Why if Indonesia catches a cold, do Brazil and Russia start sneezing? For one thing, there are financial relationships among emerging markets. Korean and Brazilian banks own Russian Treasury bonds, and in October began to unload them to raise cash. But the larger danger is psychological. Capital that rushes in can rush out just as quickly, a phenomenon Rubin remembers well from his days at Goldman, when the flows were a fraction of what they are today. Panic is a self-fulfilling prophecy, because capital flight fuels the insolvency it fears. Once the dominoes start falling, the only way to stop them is to change the psychology.

The seriousness of the problem was brought home in a series of meetings held in the office of White House Chief of Staff Erskine Bowles in October. Among those in attendance were the Secretaries of State and Defense. Concerns about South Korea were acute. If Korea failed, officials feared a spread to Brazil, one of the countries that held Korean debt, and a linchpin of the South American economy. Ultimately, they were worried about the potential for "a 1930's scenario" -- a worldwide depression accompanied by massive political instability. A consensus emerged that the U.S. could not stand by as disaster developed.

Ordinarily, the Departments of Treasury and State would fight to control policy at such a moment. But in part because Rubin, unlike many of his predecessors, does not aspire to be Secretary of State, State is not threatened by his encroachments on foreign policy. Another diplomatic advantage Rubin has brought to the situation is his unprecedented cordiality with the Fed chairman. Previous Administrations have tried to "jawbone" the Fed, nudging it to act or not act on interest rates; Rubin, though, has laid down the law from the first days in the Administration: no trifling with the Fed. This has muted the traditional rivalry between the Fed and Treasury bureaucracies.

Greenspan and Rubin and their deputies were all involved in hammering out the basic approach to the Asia crisis. It was developed on a flight to Hong Kong for the World Bank's annual meeting in September. By the time the plane landed, there was a strategy: the U.S. should lead the rescue, through the I.M.F. where possible, by providing conditional support. This approach, which was presented to Asian officials at a subsequent meeting in the Philippines, became known as "the Manila framework."

But the surveillance program put in place in Manila was a mixed blessing. In exchange for I.M.F. aid, the Koreans had to divulge information about their foreign-currency reserves. By mid-November, it was clear Korea was at risk of default. Treasury officials spent the days before Thanksgiving formulating a new financing package. The discussions continued through Thanksgiving Day in a marathon conference call composed of officials from Treasury, State and the N.S.C. (Around 6 in the evening, Rubin, Geithner, Summers and the others on the call decided to take a break and spend an hour with their families.)

The plan they eventually formulated was to support $57 billion in loans from the I.M.F., conditioned on the closure of insolvent banks and the shutting down of bankrupt chaebols, Korea's vertically integrated conglomerates. As Rubin recalled two months later on a flight to London, his view was that delay was crucial. "Buying time in these situations is very important, he said. Even if the effort in one or more of these countries was unsuccessful, if you could buy enough time, you greatly increase the likelihood that creditors and investors will distinguish among countries, and you greatly reduce the likelihood of contagion."

Near midnight on Thanksgiving night, Rubin, at his weekend house in Pound Ridge, N.Y., was on the phone with Clinton at Camp David, prepping him for calls to be put through to President Kim Young Sam in Seoul and Hashimoto in Tokyo. There was a delay in the call to Hashimoto, and Clinton was working a crossword puzzle, and asking Rubin for clues. Rubin, who does not do puzzles, passed a question to his son Jamie. "Who's so dumb they don't know that one?" Jamie asked.

"Actually," said Rubin, "it's the President."

The Thanksgiving fix didn't take. In the middle of a campaign, the Government of Kim Young Sam was unable to inspire confidence in its reforms. On the evening of Dec. 18, the day of the Korean election, Rubin convened a small dinner at the Jefferson. Foreign currency reserves in South Korea's banks were down to $9 billion, with a "drain rate" of $1 billion a day. In other words, the country would be in default by the end of the year. And for Korea to fail could be cataclysmic. Unlike Thailand and Malaysia, whose currencies had melted down months before, Korea had a vast economy in its own right -- the 11th-largest in the world, and 5th-largest among America's trading partners. "It was very, very dark," recalls Summers. "Money was pouring out of Korea. What could we do?"

There appeared to be only two choices, neither promising. The first was to let Korea fail and "try to save the rest of the world," as one of those who was at the three-hour dinner puts it. The other was to speed up loan payments from the I.M.F. and make available the so-called second line of defense -- $10 billion from the U.S. and other countries erected under the Manila framework as a final firebreak.

Summers and David Lipton, the Under Secretary of Treasury for international affairs, made the case for deploying the second line of defense. Geithner was the skeptic of the group, arguing for using I.M.F. money first and not committing American capital until there was more confidence it would improve the odds of success. Summers, whose intellect often has a cutting edge, ridiculed this incremental escalation as the "Vietnam" option. The debate was interrupted by the near-constant ringing of cell phones, and calls to the national security adviser, Samuel R. Berger, who was at the White House working out the wording for Clinton's congratulatory call to the new South Korean President, Kim Dae Jung.

When Rubin finally spoke, he emphasized the limits of America's influence. He wasn't persuaded that sending more money would be a decisive enough step to restore the confidence of international creditors and investors, who had poured capital into Korea as if it were a fixed fight, and were now fleeing as if it had become radioactive. At the end of the dinner, after one of his regular measured indulgences -- four scoops of cassis sorbet -- Rubin postponed the decision.

In this instance, his preference for optionality made the difference. In a conference call two days later, Summers, Geithner and Edwin Truman, a Fed official who works closely with them, came up with a third, more daring plan. The U.S. could try to "lever" the forbearance of the banks that held the bulk of the Korean debt. If international creditors would agree to extend their loans, U.S. officials would arrange to move forward the I.M.F. money, and make available a portion of their second line of defense if needed.

Discussion of this scheme continued as Under Secretary Lipton was dispatched to Seoul to impress the new President, Kim, with the need for financial reform and as Rubin left for a vacation in Virgin Gorda, in the British Virgin Islands, where he goes bonefishing. It was shaping up as another ruined holiday. "I brought my rods, but I didn't get to go fishing at all," he says. Instead he spent his vacation on the phone.

The situation was immensely delicate because Treasury officials felt they could not be in the position of forcing private banks to change the terms of market loans they had made. "It had to be voluntary," Rubin says. "Because if it was involuntary, then the fear was that they would all say, Well, we're doing this here, we've got to pull back from every other place, and you could set off the very contagion you were afraid of." Three days of back-to-back international conference calls culminated in a four-hour conversation with William J. McDonough, the president of the Federal Reserve Bank of New York. The plan was for McDonough to talk to the main American creditors while his central-bank counterparts in London, Frankfurt, Tokyo and Paris held synchronized conversations with bankers in their countries.

The orchestration had to be perfect, and it was. Banks in all five countries agreed to reschedule their Korean debt in the hope of eventually getting repaid in full. President Kim responded positively to the stringent conditions attached to American help, telling Lipton he intended to press ahead with reform, even if it meant layoffs and social unrest. The announcement of the second Korean rescue plan on Christmas Eve created a pivot in the crisis. By New Year's Day, the Korean stock market and the won had stabilized. Other emerging markets calmed as well. And for the next six months at least, the worst fears about a panic overtaking the world economy subsided.

The situation eased enough that in January, Rubin paused to consider the crisis as a whole. At a speech at Georgetown he tried to assess it. "Foreign investors injected an extraordinary amount of capital into these flawed systems without due weighting of the risks involved," he said. In other words, investors hadn't included a risk premium in their analysis. "I would not give one nickel to help any creditor or investor," he continued, bubbling with contempt for such sloppy thinking. "Unfortunately, there was no way to restore growth and stability without sheltering some investors."

It is possible that the I.M.F. alone could have kept Korea from default. Or that Korea would have defaulted, but not spread contagion. Or that the panic might have spread, but been perversely beneficial to the U.S. -- slowing G.D.P. growth a few tenths of a percentage point and further calming inflation fears, and easing the economy into another "soft landing." Whatever its negative effects, a Korean default would certainly have cured the "moral hazard" problem Rubin discussed -- that by bailing out investors, you encourage them to pour hot money into new speculative bubbles.

In other words, there is no way of knowing if the fact that the Asian economic crisis has not yet ended the long boom in the United States is the result of the Treasury Secretary's extraordinary skill, or sheer luck. If the crisis subsides, Rubin may yet have a chance to try to expand programs like Head Start and Pell grants, and advance the cause of some new ones he has in mind, like individual investment accounts -- I.R.A.'s for poor people. But Rubin understands better than anyone that despite his best efforts, what began with a devaluation in Thailand may yet bring the boom to an unceremonious close.

"We're dealing with issues now the world has never dealt with before," he says. "We're dealing with a multiple of countries in trouble at the same time, where the investors and creditors are not just a limited number of banks, but a vast array of individuals and institutions. That combination has never existed, so by definition you're dealing with much more difficult judgments, and much less clarity as to the probabilities of things.

"Luck or skill?" he muses. "We'll never know." On this note, conversation drifts back to Gus Levy and the banter he and Rubin used to swap on the Goldman trading floor. "Gus used to say that it's better to be lucky than to be smart," Rubin says. "And I used to say to Gus, it seemed indispensable to be lucky, but it wasn't so bad to be smart either, if you could arrange both."

Correction: July 19, 1998, Sunday

A picture caption on page 25 of The Times Magazine today, with an article about Treasury Secretary Robert Rubin, misidentifies the man at Mr. Rubin's right. He is Edward S. Knight, the Treasury's general counsel, not Deputy Treasury Secretary Lawrence H. Summers.

Organizations mentioned in this article:
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Related Terms:
United States Economy; Biographical Information

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