FINANCE

He's become a champion of massive government intervention in the economy, and he's even learning how to play nice.

THE REEDUCATION OF LARRY SUMMERS

By MICHAEL HIRSH *and* EVAN THOMAS

LARRY SUMMERS HAD THE RUMpled, slightly sleepy look of a professor who has been up all night solving equations. President Obama's top economic adviser, the man mainly in charge of the immense government bailout, splayed himself on a sofa in the Roosevelt Room in the White House, beneath a portrait of Franklin Roosevelt, and did his best to be patient with two NEWSWEEK reporters. They were asking him to explain how he had changed—reeducated himself—since the freewheeling days of the late 1990s, when Summers had been part of a government that basically got out of the way of the financial markets as they headed for the edge of the cliff.

Summers responded by quoting John Maynard Keynes, whose economic theory calling for massive government spending became identified with Roosevelt's New Deal and is at the heart of the Obama administration's stimulus plan. "Keynes famously said of someone who accused him of inconsistency: 'When circumstances change, I change my opinion'," said Summers, raising his heavy-lidded eyes at the reporters as he quoted Keynes's kicker: " 'What do you do?' " The implication, not so subtle, is that smart people are not dogmatic—stuck in one narrow ideological groove—but rather open-minded, flexible and intellectually alert—able to change with the times.

Summers is the latter—he wants you to know. In truth, he was never a wild-eyed free marketeer. As Treasury secretary at the end of the Clinton administration, he moved to regulate predatory lending practices, and he argues that credit default swaps—those weapons of financial mass destruction—barely existed back in the late '90s. "I don't think I was a great deregulator," he says, though he admits, "I'm not saying we had perfect foresight." Summers acknowledges that he has responded to changing times and changed circumstances. Last spring and summer he began to see that government's normal machinery for stabilizing the economy—the ability of the Federal Reserve to raise and lower interest rates and print money—was not working to head off a crash. He began writing lucid op-eds in the Financial Times arguing for swift government intervention and—more important—giving smart briefings to Sen. Barack Obama, Democratic candidate for president. The briefings were so good—dazzling, all present agree—that, when the time came, Obama made Summers his chief economic adviser.

Summers, 54, is perhaps the brainiest of the best and brightest assembled by Obama. The president has assembled a team of Harvard and Yale types whose SAT scores have not been equaled since perhaps the Kennedy administration. JFK brought in the likes of McGeorge Bundy, who had been appointed dean of the faculty at Harvard at 34 and whom JFK made his national-security adviser. Bundy turned out to be smart but not always wise—he urged JFK, then LBJ, to become more deeply involved in Vietnam.

INSIDE MAN: *Summers, in the White House's Roosevelt Room, has daily access to Obama*

WHEN LBJ'S CANNY OLD friend Speaker of the House Sam Rayburn heard about all the Harvards coming into the Kennedy administration, he muttered, "I just wish one of them had run for sheriff once." One wonders what Rayburn would have made of Summers, who went to MIT at 16 and later became the youngest professor ever to win tenure at Harvard (at 28). In Washington, Summers quickly became Robert Rubin's most trusted aide at the Treasury Department, ending in a brief stint as Treasury secretary himself. He went on to serve as president of Harvard for five years.

Summers is generally said to suffer from smartest-kid-in-the-class syndrome. He has heard the criticism so many times he has a slightly wounded, misunderstood air. Unlike some people who pretend to listen, Summers says he actually does listen—but he admits to an unfortunate tendency to look bored or impatient, which he acknowledges can seem rude. Summers can be playful and charmingly irreverent. But he can also just be rude.

Everyone has a Larry story, it seems. Princeton economist Alan Blinder recalls head-on collisions with Summers in the '90s. "As everybody knows, Larry is very smart and he likes to show it," says Blinder, who served on Clinton's Council of Economic Advisers and later as Fed vice chair. "Early on we had a pretty vicious debate—which Larry won, by the way—over whether the Clinton administration should be pushing large-scale 'capital account' liberalization on countries like Korea. I thought we weren't ready for that."

After he left Washington, Summers brought a similar hubris with him to the presidency of Harvard. Summers was forced to resign in 2006 after the faculty rebelled against his brusque management style. Recklessly for a university president, he tried to play the intellectual provocateur by asking whether the paucity of women in the top ranks of mathematicians and scientists was rooted in innate gender differences.

Some of the stories go well beyond complaints about his manners. Brooksley Born, chairwoman of the Commodity Futures Trading Commission, received a call in March 1998 in her office in downtown Washington. On the other end was Deputy Treasury Secretary Summers. According to witnesses at the CFTC, Summers proceeded to dress her down, loudly and rudely. "She was ashen," recalls Born's deputy Michael Greenberger, who walked in as the call was ending. "She said, 'That was Larry Summers. He was shouting at me'." A few weeks before, Born had put out a proposal suggesting that U.S. authorities begin exploring how to regulate the vast global market in derivatives. Summers's phone call was the first sign that her humble plan had riled America's reigning economic elite.

Rubin, Fed chairman Alan Greenspan and Summers were concerned that even a hint of regulation would send all the derivatives trading overseas, costing America business. Summers bluntly insisted that Born drop her proposal, says Greenberger. According to another former CFTC official who would recount the episode only on condition of anonymity, Born was "astonished" Summers would take the position "that you shouldn't even ask questions about a market that was many, many trillions of dollars in notional value—and that none of us knew anything about."

Arthur Levitt, who was head of the SEC at the time of Born's proposal, today admits flatly that she had things right about derivatives while he, Rubin, Greenspan and Summers didn't. ("All tragedies in life are preceded by warnings," Levitt says. "We had a warning. It was from Brooksley Born. We didn't listen.") Summers told NEWSWEEK: "I believed at the time, and believe much more strongly today, that new regulations with respect to systemic risk were appropriate and necessary, but expressed the strong view of Secretary Rubin, chairman Greenspan and SEC chief Levitt that the way the CFTC was proposing to go about it was likely to be ineffective and itself imposed major risks into the market." (At the time, the Rubin Treasury Department argued against the Born proposal by maintaining that the CFTC didn't have legal jurisdiction.) Still, Summers allowed that "there's no question that with hindsight, stronger regulation would have been appropriate" before the financial crash. He added: "Large swaths of economics are going to have to be rethought on the basis of what's happened." In the

PHOTOGRAPH BY KHUE BUI FOR NEWSWEEK

past year Summers has refashioned himself as a champion of intensive financial regulation. In his last column for the Financial Times before joining the Obama administration, Summers said the pendulum "should now swing towards an enhanced role for government in saving the market system from its excesses and inadequacies."

Today Summers would like to make the case that all his abrasive behavior is also ancient history. On a personal level, he says he has "mellowed." "I suspect over time there's maybe a little less of the brusqueness that people experienced when I was younger," he says. "That's probably not an uncommon thing as people get older. It may also be the seriousness of the issue and the problems lead to a greater sense of uncertainty on everybody's part."

Some of his new colleagues in the Obama administration tend to agree. "You could never call Larry Summers humble," says Christina Romer, chairwoman of the Council of Economic Advisers. "But there is a difference in him in the sense that, when he starts to make a comment, he says, 'Now, I could be wrong but ...' I feel the old Larry would not say, 'I could be wrong.' That's a nice change. That also goes for his economics ideas. There is a sense that things are hard and we could be wrong." Romer says that Obama likes to rib Summers over some of his old habits—like applying a somewhat fanciful certainty to his ideas. "One of the things you can't help but notice is that the president clearly really likes Larry," Romer says. "He enjoys teasing him about Larry's tendency to put numerical estimates on things, like 'I'm 83 percent sure that such and such ...' The president likes to play with that: 'Are you 83 or 82½ percent sure?' Then someone else will say, 'I'm going to channel Larry and say I'm 77 percent sure'."

Summers can afford to be magnanimous. He has daily access to the president, and he is widely viewed as a more substantive (or at least more convincing) Big Picture economic adviser than Treasury Secretary Tim Geithner. Summers and Geithner are good friends and tennis partners, and if there is any friction between them, it hasn't surfaced. President Obama appears to be mindful of Summers's reputation for dominating the room, and he wisely created a separate advisory panel under former Fed chairman Paul Volcker, the old sage who solved the last major economic crisis, in the '70s and early '80s. Summers welcomes the Volcker panel as advisors, but he observes, with a hint of Larry-like disdain, that it is not going to be making policy.

Which makes one wonder: has Summers really changed? Joseph Stiglitz, who was chairman of Clinton's Council of Economic Advisers and then World Bank vice president, has his doubts. Back in the '90s, Stiglitz fought some epic battles against Summers. Stiglitz wanted more controls over the flows of capital around the globe, and Summers mostly argued for the Rubin-Summers-Greenspan free-market approach. "He ignores arguments he doesn't like," says Stiglitz.

Stiglitz contends that the Obama administration is dominated by such old Rubin protégés as Mary Schapiro, chairwoman of the SEC, and Gary Gensler, who's awaiting confirmation this week as head of the CFTC, who have been identified with weak regulatory policies in the '90s. While some economists have advocated even greater government intervention to solve the current crisis, including nationalizing troubled banks, Summers seems to be trying hard to avoid swinging back too far toward overregulation. "He's very much a market man. He'll come out more on the side of lighter regulation," says political consultant David Gergen, an old friend.

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THE "NEW LARRY" MAY TURN out to be like the "new Nixon." Still, there are signs that Summers really is learning to play well with others. When Carol Browner was EPA chief in the Clinton administration, she clashed with Summers—Browner pushed for greener policies while Summers argued that they'd hurt the economy. But now that Browner is chief environmental adviser in the Obama administration—and Obama has made clear his pro-green views—Summers is working closely and, by early accounts, harmoniously with her. And he played the consummate politician in forays to the Hill to sell the stimulus package in recent weeks, listening with patience to the sometimes economically illiterate arguments of senators and congressmen. "It's remarkable how totally accessible he is, even more than others" in the administration, says Sen. Max Baucus, chairman of the Finance Committee. "He's very patient, answering everyone's questions. I remember thinking, holy mackerel, he must be asking himself, 'When can I leave?' "

Recalling Summers's pitch for the stimulus bill at a recent Democratic retreat, along with those of Geithner and budget director Peter Orszag, Baucus says, "He was so articulate. I stood up and said, 'This is all very reassuring,' and I was thinking, Larry in particular." All in all, it was a remarkable change from the scruffy Treasury undersecretary who used to treat important legislators like the hapless foils he once trampled as a national debate champion. "He listened more than he talked, and said, 'I don't have all the answers.' Which, if you know Larry Summers, wasn't always the case," says Brendan Daly, spokesman for House Speaker Nancy Pelosi.

When Geithner rolled out the Treasury Department's bank-bailout plan two weeks ago, Wall Street was underwhelmed. Bankers—and not a few ordinary citizens—asked: where are the specifics? It was widely speculated that Geithner was being intentionally vague because he could not publicly concede that many big banks were insolvent and might have to be nationalized. Summers denies this, insisting that the administration still had to take the full measure of the crisis through "stress testing" the banks. But humbly, being the "new Larry," he doesn't dispute suggestions that the Obama economic team could have done a better job managing market expectations.

Summers's greatest test will be persuading Congress to vote for "entitlement reforms"—i.e., cutbacks and/or higher taxes on Social Security and health benefits for the poor and elderly. In his interview with NEWSWEEK, Summers made clear that he will urge the president and Congress to venture into an area where politicians have long feared to tread, the so-called third rail of politics (touch it and you're dead). Necessity requires it, he says—if the United States cannot curb its spending and debt, interest rates will soar and the economy will plunge once more. Summers will make the arguments used by Keynes that changed circumstances call for changed views. He will have to make the argument a little less haughtily than Keynes did, however—or than the new Larry sometimes still does. ■