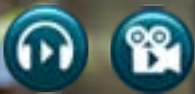


The Pragmatic IDEALIST

Maureen Burke profiles Peter Blair Henry



As a child in Jamaica, Peter Blair Henry would watch in quiet puzzlement as a woman from the neighborhood came to his grandmother's gate from time to time, asking for food. He wondered why his family always had enough to eat while this woman, with her matted hair and distended belly, did not.

This contrast between the haves and the have-nots became even starker a few years later, when Henry emigrated with his parents to the United States, landing in the comfortable Chicago suburb of Wilmette. Seeing only affluence around him, the nine-year-old Henry was deeply stirred by the fact that people were so much better off in the United States than they were back home. This fundamental question of development—why standards of living vary from country to country and what can be done about it—has been a “personal obsession” ever since, Henry says.

Now dean of the Leonard N. Stern School of Business at New York University (NYU) in the heart of New York City, Henry has come a long way from the rural Jamaica of his youth.

Striding into NYU's Henry Kaufman Management Center across the street from Washington Square Park on a beautiful fall morning, he displays an easy rapport with security

guards, students, and professors alike. As he passes through the lobby, he eschews the elevator and takes the stairs to his office instead. All 10 flights.

Institutions versus policies

The youngest dean in the Stern School's 113-year history, Henry, 44, has devoted much of his career to studying the impact of economic reform on the lives of people in developing countries. His research has sometimes challenged conventional wisdom—whether on debt relief, international capital flows, or the role of institutions in economic growth.

His study “Institutions versus Policies: A Tale of Two Islands,” coauthored in 2009 with Conrad Miller, is a good example.

The study chronicled the widely divergent economic performance of Barbados and Jamaica. “It may be tempting for readers to regard this paper as a quaint tale of two exotic islands better known for their beaches, music, and Olympic sprinters than their significance in the global economy,” the authors write. “On the contrary, we think that important general lessons lie at the heart of this Caribbean parable.”

“A Tale of Two Islands” set out to disprove the hypothesis that institutions play the decisive role in a country's develop-

ment. That theory—advanced, among others, by economists Daron Acemoglu, James Robinson, and Simon Johnson in a 2000 paper—holds that prosperity is created by incentives, and incentives are created by institutions. In 2012, Acemoglu and Robinson developed that premise at length in a best-selling and highly acclaimed book *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*.

Henry and Miller, both then at Stanford University, challenge this view, making the case that policies—not institutions, geography, or culture—are the determining factor in why some countries are rich and others poor. Comparing Barbados and Jamaica, two former British colonies that inherited almost identical political, economic, and legal institutions, they argue that the sharp divergence in the two countries' standards of living was attributable to something else—namely, the government's economic policy choices.

The former colonies followed widely divergent paths in the 40-year period following their independence in the early 1960s. The Jamaican government during the 1970s and 1980s ran large budget deficits, restricted international trade, and intervened extensively in the economy. By contrast, Barbados achieved fiscal discipline, kept state ownership to a minimum, and embraced open markets.

The result is striking. In 1960, real income per capita was \$3,395 in Barbados and \$2,208 in Jamaica. Today, the picture looks far different. Barbados is much wealthier than Jamaica, with income per capita of \$15,198 compared with \$5,358.

“Henry and Miller are, of course, right that one should pay attention to the independent effects of macroeconomic policies,” wrote Acemoglu and Robinson recently in their blog. “But economic policies don't just drop out of the blue. They are chosen by governments and politicians whose incentives are determined by political institutions.” So the argument that policies but not institutions distinguish Jamaica from Barbados is not compelling, they say.

Though not everyone is convinced, many people find Henry and Miller's study intriguing because it is a near-natural experiment on what factors determine economic success or failure.

No room for millionaires

Henry spent the first eight years of his life in Jamaica, which is why “A Tale of Two Islands” has special significance for him. “When I was a kid, I remember listening to the speeches of Michael Manley,” Henry reminisces, recalling Jamaica's former prime minister as an intelligent, caring leader—one who wanted to make life better for all, especially the poor.

“But Manley went about doing this in a way that was inimical to the market—and to growth, in hindsight—embarking on a series of economic experiments that threw the country very deeply into debt and led to essentially eight straight years of extraordinary contraction in the economy,” Henry explains.

In a 1977 speech, Manley declared that “Jamaica has no room for millionaires. If you want to be a millionaire, there are five flights a day to Miami.” This was seen as an open attack on business, Henry says.

A lot of Jamaicans took Manley at his word—among them Henry's parents. Although they had no intention of trying to

become millionaires—Henry's father was a chemist and his mother a botanist—they found it increasingly difficult to thrive in Manley's Jamaica, so they resettled with Peter and his three young siblings near Chicago.

Out of his comfort zone

As an undergraduate at the University of North Carolina at Chapel Hill (UNC) in the late 1980s, Henry got hooked on economics, which seemed to offer him a perfect way to com-

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bine his love for math, science, and problem solving with his interest in social issues.

Henry attended college on a Morehead Scholarship (now called the Morehead-Cain Scholarship), a full, four-year merit scholarship for UNC students. Inspired by the Rhodes Scholarship, the program selects students based on their moral force of character, scholarship, physical vigor, and leadership.

The scholarship included a summer enrichment program that allowed participants to pursue fully funded work or study experiences anywhere in the world. At his mother's urging, Henry sought, and won, a summer job as a research assistant for a professor at Oxford University's St. Antony's College who was researching the role of free economic zones in the Soviet Union's economy just years before it disintegrated. After graduating with a B.A. in economics in 1991, he found himself back at Oxford as a Rhodes Scholar, studying for a second undergraduate degree, this one in mathematics.

“The Rhodes experience was a great way to get out of my comfort zone,” Henry says.

Accustomed to the frenetic schedule of a typical U.S. college student, he discovered that life at Oxford unfolded at a different rhythm altogether. It was the era before cell phones, and most students didn't even have landlines. Students would communicate mainly by “pigeon post,” an ancient system whereby the colleges' porters would hand-deliver messages around campus. The pace at Oxford “really forced me to slow down and read for a degree, which gave me the chance to think more deeply,” Henry says.

Henry went on to enter the doctoral program in economics at the Massachusetts Institute of Technology (MIT), where he had been granted deferred admission while still at UNC. It was another summer research gig that led Henry to his Ph.D. thesis topic, and perhaps ultimately to a career in business education.

Henry asked the late Rüdiger Dornbusch, one of his professors at MIT, if he could do a summer research project for him on the debt crisis that engulfed Latin America in the 1980s. Dornbusch suggested instead that Henry gain some real-life experience by working with K. Dwight Venner, Governor of the Eastern Caribbean Central Bank. Venner was looking to develop long-term capital markets in the eastern Caribbean and wanted to avoid the problems that had plagued countries

like Chile and Argentina. Offered a small stipend and a place to live, Henry headed off to St. Kitts for the summer of 1994. The paper he wrote for Venner ended up forming part of the intellectual basis for the Eastern Caribbean Currency Union's first securities exchange.

That experience got Henry thinking more and more about the relationship between capital markets and development. Should an emerging market economy open its capital markets to foreign investors? What are the consequences of doing so—does it reduce the cost of capital as economic theory predicts? And is there a link with economic growth? His 1997 doctoral thesis centered on these questions, using data from the large emerging markets in Latin America and Asia.

Ants and grasshoppers

Today, Henry remains deeply interested in emerging market development, the topic of his first book, *Turnaround: Third World Lessons for First World Growth*, published in March. The book's premise is that many former "third world" nations have pulled off a historic economic turnaround, becoming the emerging markets that now drive global growth.

"It seemed important to me that they did this [turnaround] with three decades of economic reforms that were pushed on them by the first world—nations now battered by crises, but whose governments appear loath to take their own prescriptions," Henry told Dan Schawbel of *Forbes*.

Turnaround uses data on stock prices, GDP, and inflation to demonstrate that emerging markets were able to achieve remarkable economic success through the application of three key principles: *discipline*—a sustained commitment to a pragmatic growth strategy that is vigilant, flexible, and values what is good for the country as a whole over what's good for any individual or interest group; *clarity*—in other words, a clear commitment by the country's leaders to a change of direction; and *trust*—between citizens and their government, for example, or between two countries.

To illustrate what he means by discipline, Henry points to Aesop's fable "The Ant and the Grasshopper," in which the grasshopper spends the warm months singing while the ant stores up food for winter. When cold weather arrives, the grasshopper finds itself dying of hunger and begs the ant for food.

The United States, Henry says, is an advanced economy grasshopper. During the flush times when the country had a fiscal surplus, President George W. Bush decided in 2001 to give it away in the form of tax cuts rather than saving it. When the financial crisis hit later that decade, the country didn't have the cushion it needed to soften the blow.

Chile, on the other hand, can be seen as an emerging market ant. After Andrés Velasco became Chile's finance minister in 2006, the country's treasury swelled with money from booming copper prices. Even in the face of popular protests, Velasco resisted the urge to spend the windfall. His strategy of saving for a rainy day paid off—when the country was slammed by the financial crisis, the Chilean government had the financial means to offer its citizens a \$4 billion tax cut in 2009 to blunt the impact.

Is debt relief good or bad?

As a student, Peter Henry strongly believed that debt relief for poor countries was a good idea. But after examining the evidence, he changed his mind.

In his research, he set out to see if debt relief would stimulate economic growth in highly indebted countries. He was familiar with the notion that excessive external debt deters investment in a country; high levels of debt imply high future tax rates, because more tax revenues are needed to service the debt. According to this "debt overhang" theory, writing off debt generates more investment and higher growth, with positive results for the country.

Henry studied the data, and found that for middle-income developing economies—particularly those in Latin America that were granted write-downs of bank debt in the 1980s—debt relief actually did create value.

But the low-income countries that received debt relief later under the joint IMF–World Bank Heavily Indebted Poor Countries Initiative did not have much of a market for private capital. As a result, he discovered, writing down the debt of these countries did not spur growth. Unlike in the middle-income Latin American countries, the main economic difficulty for poor countries is not debt overhang but the absence of basic economic infrastructure that provides the foundation for profitable investment and growth.

Such initiatives are thus not going to do much to help poor countries. In fact, they may actually hurt. "To the extent that more resources are part of the solution, you'll see that debt relief has not resulted in more resources, on net, going to poor countries," Henry notes, saying that multilateral institutions simply reduce the overall aid envelope available to these countries by an equivalent amount. So debt relief effectively results in more bilateral aid—which Henry says is generally less effective than multilateral aid because it is often politically motivated.

Henry has taken a lot of heat for his position on the topic. But, he says, "if we want to really help countries do what's efficient as opposed to making ourselves feel good," we should look at the evidence.

"If we would only have the humility to observe the lessons that much of the third world provides, there'd be a more prosperous future for us all," Henry says.

Emerging market economies have indeed made remarkable progress over the past two decades. They now account for more than half of world GDP (in purchasing power terms), compared with less than a third in 1990. Moreover, these economies did so well during the past decade that, for the first time, emerging market and developing economies spent more time in expansion and had smaller downturns than advanced economies, according to the IMF's October 2012 *World Economic Outlook*.

But there are signs that dramatic growth in emerging market economies is drawing to a close. Their average growth is 1½ percentage points lower than in 2010 and 2011, the IMF says. Growth in advanced economies, on the other hand, is picking up.

In addition, certain emerging economies have experienced market turmoil in recent months. Brazil, India, Indonesia, South Africa, and Turkey—Morgan Stanley’s “fragile five”—were seen at risk for a currency crisis after their currencies fell by between 13 percent and 23 percent between May and August 2013. While some of the turmoil can be explained by cyclical factors, many economists see these countries’ large current account deficits, high inflation rates, and high corporate and household leverage as troublesome—and perhaps also the result of bad policy.

So do recent developments invalidate Henry’s thesis? No, he says: “It’s important to separate the cycle from the trend.”

“There’s been a narrative in the financial papers in recent weeks saying that the BRICS [Brazil, Russia, India, China, South Africa] are falling and the advanced economies are back on the rise. That suggests a zero-sum game—a sort of hegemonic world, which I think is the wrong way to think about things,” he muses. “Growth in the emerging markets is good for growth in the advanced economies.”

“A big part of the reason why emerging economies have emerged over the last two decades is because of their hard-won reforms,” he adds, acknowledging that there is still much to be done.

Greater voice

“Peter really does think a lot about developing countries, and he always has, from the moment I met him,” says Serkan Arslanalp, an IMF economist who studied under him at both MIT and later at Stanford University’s Graduate School of Business. Henry’s intellectual outlook has been shaped by his background—sometimes in ways that surprise (see Box). “I was born in Jamaica but was educated by, and now serve, prestigious first-world institutions, so I believe that I have a unique, dual perspective,” he told *Forbes*.

It was likely because of this unique perspective that then-U.S. President-elect Barack Obama asked him in 2009 to lead a transition team that studied international financial institutions such as the IMF and the World Bank.

Henry was a strong advocate for a greater emerging market voice in the IMF then, and still is. The transfer of voting shares from advanced European economies to emerging market and developing economies in recognition of the global economy’s changing dynamics is a fundamental step, he says. “It’s key that they be recognized for the strides that they’ve made.” (The IMF quota reform that would sanction this shift was approved by the Group of Twenty in 2010, but at the time of this writing, it had not received the necessary ratification by the United States, the IMF’s largest shareholder.)

When he was tapped by Obama, Henry was the Konosuke Matsushita Professor of International Economics and Associate Director of the Center for Global Business and the Economy at Stanford’s business school, which he had joined 12 years earlier as a freshly minted Ph.D.

Then NYU came knocking.

“I never thought I would leave Stanford, to be honest,” he says, expressing appreciation for such Stanford colleagues as Anne Krueger and John Taylor, who he says pushed him on

his ideas. But the new opportunity was just too seductive. So he moved across the country with his four young sons and his wife, Lisa, a Yale-educated child psychiatrist.

“NYU Stern is a great business school that has even greater aspirations, with a world-class faculty that made huge contributions during the financial crisis,” Henry says.

And the feeling is mutual. “After some time, one can read the body language of a dean’s search committee. Seldom—if ever—have I seen greater certainty or more enthusiasm for a candidate for a deanship,” said NYU President John Sexton of Henry in a 2009 statement. “And when I met with him, it was immediately apparent why: [he is] a superb and highly productive economics scholar, a natural leader, a community builder, and a manifestly good person.”

Doing well and doing good

At NYU since January 2010, Henry says he is particularly enthusiastic about the recent international expansion of the university, which opened branches in Abu Dhabi in 2010 and Shanghai earlier this year. Although the business school does not have its own campuses in these places, it is beginning to expand its offerings abroad. In Shanghai, Stern has just started up an innovative master’s program in business analytics, and other initiatives are in the works.

This new international dimension has helped Henry lure top-notch professors such as former Stanford colleagues Michael Spence (a 2001 Nobel laureate) and Paul Romer. Yuxin Chen returned to Stern this year after several years at Northwestern University.

“There is a whole host of problems that are fundamentally global in nature, but that require the additional tools of business to be applied with a broader lens,” Henry says. “What role does finance play in helping us figure out how to allocate capital efficiently around the world? What role does marketing play in helping us think about how we reach poor consumers through digital media? How do we think about luxury consumers as not just high-income people in the United States and Europe, but also newly salaried female entrepreneurs in Nigeria and Indonesia?”

In an interview earlier this year, the *New York Times* suggested to Henry that he might be better off heading an NGO than as dean of a business school if he wants to help people in developing countries. “Things that drive up shareholder value can actually be very good for society at large,” Henry responded. “We have to have a different way of thinking about the role of business in society.”

Others would agree—among them World Bank President Jim Yong Kim, who recently noted that global official development assistance amounts to only about \$125 billion a year, the equivalent of the infrastructure needs in Africa alone. “If you have high aspirations for the poor,” Kim said, “you’ve got to really think hard about the role of the private sector.”

That is something Henry has long believed. “One of the big lessons that I take away from the Manley years in Jamaica is that you can’t help the poor by bashing business.” ■

Maureen Burke is on the staff of Finance & Development.