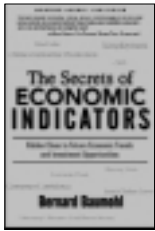


## *The Secrets of Economic Indicators*

By Bernard Baumohl. 2005. Upper Saddle River, New Jersey: Pearson Education, Inc., published via Wharton School Publishing. Pp. 366. \$27.95 hardcover.



In the past several years, especially since the stock market crash in 2000, investors have been assuming greater responsibility for managing their own investment accounts. This activity has led to questions about the economic factors that move stock prices. This in turn has led to a number of books that describe the various economic indicators and reports that are published regularly, together with comments on their impacts on stock and bond prices as well as the dollar in foreign exchange. Baumohl's book is one of the latest in this group of books.

Baumohl is well qualified to write on this subject. He is the director of The Economic Outlook Group, a consulting firm that evaluates global economic trends and risks. Prior to that, he was *Time* magazine's economics reporter for two decades, covering the domestic and international economies. He also served as an economist for the European American Bank and as an analyst for the Council on Foreign Relations. He also is an interesting writer with a light touch, so that the text is easy and informative reading. His focus is on which indicators have the greatest influence in the markets, which do the best job in predicting where the economy is heading, where the data are found most easily, and how can you interpret them.

The book starts with a fascinating description of "the lock-up," the process used by the government to assure simultaneous availability to everyone of economic data when they are released, so that no leaks give anyone advance information that could be used improperly.

The next section of the book has a clever chart that takes the components of real gross domestic product (consumption, investment, inventory change, government spending, and net exports) and signs of price pressures, matching each segment up with the key economic indicators for that segment. Subsequent tables list the economic indicators most sensitive to stocks, bonds, and the dollar, as well as the top ten international economic indicators. Before the author gets into the meat of the book, he also provides a beginner's guide to the economic jargon encountered in using the data, such as annual rates, real and nominal dollars, moving averages, revisions and benchmarks, and seasonal adjustments.

With this background, the book then turns to a description of individual economic indicators. Each indicator is described, together with its market sensitivity (very high, high, medium, low), availability on the Internet, release time, frequency, source, and revisions. Particularly useful information is a description of how each indicator is computed. Sections of the actual tables of the release are provided to illustrate what the report itself looks like. At the end of each description, a brief summary lists the market impact on bonds, stocks, and the dollar.

Following the description of just about all the major economic indicators, the author provides something not usually found in this type of book: a discussion of international economic indicators and why they are important.

He also lists ten most important international indicators that include data for Germany, France, the Euro zone, the OECD, China, and Brazil. The detail is in the same format as that provided for U.S. indicators, and all of the references are available in English. The concluding chapters discuss the best websites for U.S. and international economic indicators.

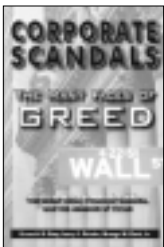
As a reference source, this book provides essential information and also covers many areas that are not discussed in similar books. It is a valuable resource for any business economist or investor who wants to be better informed about the economy and the effects of economic data on the markets. It is a useful tool for both the novice and the knowledgeable practitioner.

In no way detracting from the excellence of this book, perhaps in another book and at another time, the author could turn his considerable skills to a discussion of two other subjects that should be of significant interest to investors. One is the wealth of data on corporate profits in the national income accounts that cover the components of profits, productivity, and unit costs. While not widely disseminated and not great market movers, this information reveals more about the anatomy of aggregate profits than that found in the usual reports to shareholders. The second subject would be a discussion of the functions and structure of the Federal Reserve, the formulation of monetary policy, and interpretation of the arcane communications of the Federal Open Market Committee. Baumohl would be a great read on these topics!

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## Corporate Scandals: The Many Faces of Greed

By Kenneth R. Gray, Larry A. Frieder, and George W. Clark, Jr. 2005. St. Paul, MN: Paragon House. 320 Pp. \$19.95 hardcover.



Enron, Tyco, WorldCom, Global Crossing, Imclone. This is an abbreviated list of corporations involved in scandals that rocked the financial markets, decimated the lives

and fortunes of millions of employees and investors, and set in motion a wave of legislative reforms in the early years of the 21st century. Corporate scandals have been around as long as corporations themselves. As Yogi Berra would say, “It’s not over ‘til it’s over.”

Given that the wave of corporate scandals has had such long-lasting and far-reaching impacts on the U.S. economy, it is very important that business economists have a complete understanding of this subject. In this regard, I strongly recommend *Corporate Scandals: The Many Faces of Greed* by Professors Gray, Frieder, and Clark (GFC). The book attempts to be the complete guide to the subject, and for the most part, succeeds in achieving its goal. It begins with a history of corporate scandals dating from the early 18th century through the savings and loan scandals of the 1980s. Other chapters review fully the corporate scandals from the last few years, both those on Main Street and those on Wall Street.

The impacts of corporate scandals are not limited to the investors and employees of those companies involved. The externalities of this misbehavior spill over to the entire economy, affecting both publicly

traded companies and privately held ones as well. Thus, it is not surprising that there is a government response. One of the most important topics discussed in the book is the Sarbanes-Oxley Act (SOA), which was passed in haste and in anger in August 2002, and its offspring, the Public Company Accounting Oversight Board—the new government agency charged with eliminating accounting abuses and improving the auditing process. Though the speed and emotions behind SOA may have been justified, the resulting legislation suffered accordingly. While the authors cite the effectiveness of SOA in prosecuting HealthSouth, they acknowledge that SOA was written specifically to address extreme and outrageous corporate accounting behavior of a handful of companies. The costs of complying with SOA, however, are borne by all public companies. Thus, the legislative penalty may be worse than the crime it is intended to prevent.

GFC acknowledge the ways in which SOA raises the costs of doing business, but they feel these costs are more than offset by the benefits of improved accounting practices and greater public trust in corporate America. A lack of public trust tends to boost a firm’s cost of capital; hence, SOA can be helpful on the cost side as well.

Nonetheless, SOA may be a modern-day example of “the fallacy of composition,” as described in Paul Samuelson’s *Economics* (1955, 9-10). To wit, “What is prudent behavior for an individual or a single business firm may at times be *folly* for a nation or a state” (a famous example being Keynes’ “paradox of thrift”). In the context of today’s economy, an attempt by a corporation’s management to exercise an extra degree of prudence in plant and equipment spending and hiring behavior will, in

the end, if practiced widely enough, produce a reduced appetite for risk-taking and therefore may reduce production and employment throughout the economy. It is reasonable to hypothesize that business activity will be reduced, not necessarily to recession levels, but to levels well below the economy’s underlying dynamic potential (were corporate behavior less risk averse). While there are many explanations for the investment bust of 2000-03 and the prolonged weakness in employment growth that followed the short recession during 2001, the attempt of corporate managements to “clean up their act” through compliance with accounting and auditing requirements of SOA may have been an important factor. These unintended potential macroeconomic consequences of SOA are addressed tangentially, but are not the authors’ primary concerns.

The record of 2000-2003 is consistent with major corporations working to bring more top-line revenue down to bottom-line profit by deferring any expenditure that could be deferred. How else could they sign the accounting attestations required by SOA? During this same period, small, privately-held businesses (as revealed through surveys by the National Federation of Independent Business) expanded their activity at about the rate that would be expected given the general state of the macroeconomy. Large, publicly traded companies comprise roughly half of the U.S. business sector. Had their share of business activity been greater, their increase in thriftiness and prudence might have deepened or prolonged the recession. Indeed, had it not been for the swift and aggressive reaction of monetary policy to offset the economic headwinds stemming from the behavioral changes induced by SOA (and several other negative

demand shocks), the U.S. economy might still be in recession. GFC do an excellent job of analyzing the SOA's impacts on the microeconomic incentives and the behaviors of corporate executives and their directors, but they are incomplete in their coverage of the potential macroeconomic consequences.

In addition to SOA, other chapters deal with the agency problems involved in excessive CEO compensation and the market and institutional failures that fostered the behavioral breakdowns associated with the wave of corporate scandals. GFC examine the full range of interventions and changes in incentive systems that could reduce the likelihood of future scandals. While they have not lost faith in the free-enterprise, capitalist system, the authors put more faith in government regulation than I do. They devote a full chapter to the teaching of business ethics and the role it can play in creating a new generation of more (socially) responsible business leaders. But tomorrow's business leaders will be competing in an ever-more globalized economy against companies run by leaders whose moral compass is influenced by a more diverse set of ideas than the locally-accepted ethical standards taught in the United States. Clearly, there is no "easy fix" for averting corporate scandals in the future.

Each chapter ends with a half dozen penetrating questions for the reader. To answer these questions, the reader must reflect carefully, not just about the content of the chapter, but about the moral and ethical dilemmas posed by the incentive systems of the corporate world and the behaviors it sometimes fosters. In this sense, the questions place the reader in the middle of the action, thereby encouraging reflection on how he or she would react if placed in a similar

situation. (This is one of the books many strengths.)

The authors believe in and teach the benefits of the free enterprise system. It is only natural that they ask "what went wrong?" The book challenges us to think about the true complexities of the problem and the difficulties of simultaneously encouraging and regulating greed through the forces of Adam Smith's invisible hand. It might, however, have paid more attention to the potential for unintended consequences of excess regulation and overkill legislation, such as Sarbanes-Oxley. Like it or not, virtuous human behavior cannot be achieved by statute.

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#### REFERENCE

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