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A CRISIS IN COORDINATION AND COMPETENCE

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The ad hoc emergency approach to the current economic crisis has a great chance of wasting billions of dollars by mismatching skills and needs. The current deepening recession needs a "quick fix" solution now, but a longer-fix solution must be put into place along with it. (See also, Policy Note 2009/5.)

There is already considerable talk about the possible need for a large public works program to follow the massive infusion of funds into the financial and automobile sectors. But who is going to manage it? For us to weather this great economic storm we need to line up and coordinate (at least) four sets of highly different talents—political, bureaucratic, financial, and industrial. Without their coordination, economic recommendations, no matter how good they may appear to be in theory, will fail in execution.

Expectations play a critical role in a dynamic economy: they become self-fulfilling. If they spiral downward, they take the economy with it, accelerating any downturn; or, in boom times, investor euphoria can lead to unduly inflated asset values. A healthy economy has to dampen both the downward and upward swings in expectations. We are currently reaping the harvest of the housing boom, where, once the expectation of ever-rising prices was dashed, the market promptly nose-dived.

Most Americans wish to live in unexciting times, with prices that are more or less stable, and public expectations reflect this desire for stability. The public neither wants nor requires learned explanations about what has gone wrong in the economy. It simply wants the economy fixed. Politicians on both sides of the aisle are aware that they have to cater to their constituencies *now*, and are willing to risk the quick fix because political reality forces them to do so.

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As much as we may not like it, not only do we have to gamble, but we also have to use the pool of talent and the information we have now. This means that, in spite of public anger at the greed of the financiers and the real possibility of pork-barrel spending and private profiteering from massive public works programs, we have to enlist the help of many of the individuals associated with bringing on the crisis in the first place.

There are a few principles that must be followed. In particular, government should not buy assets where it has neither the technical nor the administrative ability to manage them. The failure of financial institutions has a “fast network” (negative) effect on national and global financial markets. Therefore, these institutions cannot easily be placed in bankruptcy and must be reorganized, with the government taking a senior position in providing financial guarantees at a potential profit. Management must also be reorganized, with the more egregious “masters of the universe” fired but many of the mid- and upper-level managers retained.

Firms that produce goods are different from those that provide services. In every instance, two questions must be asked: Is the firm sick or healthy from the viewpoint of its ability to produce a saleable product? Is it healthy from the viewpoint of its financial structure? Firms that are healthy by both measures need no help. Those that are unhealthy by both measures should be left to liquidate. Firms that have a healthy business but a bad financial structure should be helped to reorganize. Those with a track record of imperceptive management, such as General Motors, should be left to either manage their own reorganization or go bankrupt.

Bankruptcy measures, both for reorganization and for liquidation, should be used decisively. A majority of the public fears the bankruptcy of large firms because the mythology circulated by both upper management and the unions is that it will cause massive layoffs. If done well, the reverse is true: upper management is fired, and the firm, along with many of its other workers, is taken over by new, more efficient management. The bankruptcy laws and procedures in the United States are probably better than anywhere else in the world; nevertheless, they need to be made far less costly to implement than they are.

Another myth promulgated by top financial and nonfinancial firms in the United States is that if we were to cap pay and bonuses in any way for the senior managers of publically traded firms we would ruin incentives and destroy economic innovation. Let private entrepreneurs and partnerships earn what they can, but top corporate managers who are public fiduciaries have other responsibilities. It is doubtful that the top thousand corporation presidents and other public company bureaucrats will all migrate to Switzerland and Hong Kong, or that the free-enterprise system in the United States would suffer great damage even if they did.

The primary targets in a crisis such as this are employment, consumption, and innovation. Expectations will start to change only after it is perceived that decisive actions are being taken. Fast, flexible weapons include tax cuts for those earning less than $100,000 a year, deficit spending at the state and federal levels to maintain public services and programs, and appropriate reinsurance to enable the valuation of distressed assets. Less flexible but needed are a broad revamp of credit controls and the addition of saving incentives to cut the levels of consumer credit card and mortgage debt.

If the crisis deepens, pump priming via public works programs such as upgrading roads, bridges, and other public transport systems in the United States may appear attractive in rhetoric, but in reality they depend in detail not merely on the availability of unemployed resources but also on the availability of the right resources. If promoted without sufficient forethought, the pork-barrel features of such projects can easily overwhelm the benefits.

In the immediate future we must be prepared to see an enormous explosion in entrepreneurial retraining programs and new for-profit educational establishments bent on selling the newly unemployed hope of acquiring a job elsewhere. Because we have had no planning or forethought from previous administrations about a serious downturn in the economy this activity will be highly haphazard, but hopefully, despite waste and (in some instances) blatant hucksterism, it may be better than nothing. We have no choice but to go for short-term fixes now. But a responsible administration, after its needed reaction to the immediate problems, must make provisions in the institutional structure to provide for early warning and thoughtful action before the situation turns into one that requires political reaction and patchwork fixes that can only work by serendipity.