A Crisis in Coordination and Competence

The ad hoc emergency approach to the current crisis has a great chance of wasting billions by mismatching skills and needs. The current deepening economic recession needs a “quick fix solution” now, but a longer fix solution also must be put into place along with the quick fix.

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 sector and into the automobile industry. 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. They are political, bureaucratic, financial and industrial talent. 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. If they spiral downward. They become self-fulfilling and take the economy down accelerating the downward gloom or, in boom times increasing an upward euphoria. 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 euphoria of expectations for ever rising prices was replaced, expectations promptly accelerated in the other direction.

Most of the American public wishes to live in unexciting times where prices are more or less stable and expectations reflect this stability. The public neither wants nor requires learned explanations about what has gone wrong in the economy. It wants the economy fixed. The politicians on both sides of the house 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.

As much as we may not like it, not only do we have to gamble, we 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 possibilities of pork barrel opportunities and profiteering from both the financing and public works programs we have to enlist the help of many of the individuals associated with bringing on the crisis.
There are a few principles that must be followed. In particular government should not buy assets where it has neither the technical nor administrative ability to run them. The failure of financial institutions has a fast network effect in the national and global financial markets and cannot be easily placed in bankruptcy. They have to be reorganized with the government taking a senior position in providing financial guarantees at a potential profit. Managements must be reorganized with the more egregious “masters of the universe” fired but many of the professional retained.

Firms producing goods and services are different. 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. Those who 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. Businesses with a track record of imperceptive management, such as General Motors should be left to manage their own reorganization or go bankrupt.

Bankruptcy measures both for reorganization and liquidation should be used decisively. Many of the public fear bankruptcy of large firms because the mythology circulated by the upper management and the unions has it that it will cause massive unemployment of the workers. If done well the reverse is true. It is the upper management that gets fired and the firm along with many of its other workers is taken over by an efficient management. The bankruptcy laws and procedures in the United are probably better than anywhere else, nevertheless they need being made far less costly than they are.

Another self-promoted myth of the top financial and non-financial firms in the United States is that if we were to cap pay and bonuses in any way for upper management of publicly traded firms we would ruin incentives and destroy innovation in the economy. 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 corporate presidents and other public company bureaucrats will all migrate to Switzerland and Hong Kong and that the enterprise system of the United State would suffer great damage even if they did.
The immediate 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. Flexible fast weapons include tax cuts for those earning under $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 the revamping of credit controls and incentives to cut the levels of consumer credit card and mortgage debt.

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

In the immediate future we must be prepared to see an enormous explosion of entrepreneurial activity in retraining programs and new for-profit educational establishments selling the newly unemployed the hope of jobs elsewhere. Because we have had no planning or forethought from previous administrations about a serious down turn in the economy this activity will be highly haphazard but hopefully in spite of 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 must, after its needed reactions to the immediate problems must put 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.

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