



January 31, 2009

Dealing with the Recession

Two genuine financial and economic experts has held forth yesterday on the recession, on what it is, on how we got here, and where the best course of action lies now. One of them is Joseph Stiglitz, a recent Nobel laureate in economics who teaches at Columbia University. The other is a legendary speculator George Soros, founder of the most famous of all mutual funds, Quantum Fund. I would say that Soros is the more perceptive thinker. He has an important insight into the cause of the collapse of the financial system: compounding of mispricings. Stiglitz really seems not to have a clue, and doesn't claim to have any.

One of the unavoidable facts of life is that when we all agree on something, on some fact or on the wisdom of some course of action, we also agree even more wholeheartedly that our conclusions are almost sure to be accurate and our actions wise. We judge risk from dissonance and safety from the absence of it. So some entrepreneur tries something that works, whether it was supposed to work or not, whether or not it was actually a good idea. I am not being cynical; it probably was a very good idea. The point is that by judging from outcomes there is no way to know. Anyway, more people imitate the first one, lending to that kind of decision the weight of numbers.

Now the dynamics get rather brutal. The less a given decision maker knows, the more likely he is to slavishly follow the leaders. In so doing he seems to become a (somewhat tardy) leader himself. So, the less a given decision maker knows, the smarter he looks to everyone else. This leads to irrational crowd following and lemming-like stampedes over the cliff. The interesting point is that it is inevitable. Human societies will always behave this way and repeat these mistakes.

This is in essence what Soros is talking about. He is, by the way, an extremely political man, and Barack Obama has been his horse in the race from the beginning. Apparently no one was more influential in starting Barack on the course that brought him to the White House. Soros has a particular, and perhaps highly understandable, ax to grind, which is to dismantle the Russian Empire. Hungarians tend to feel that way about Russia. He is however not a militarist as far as I – which in this case is not far at all; I am limited to his book on the end of American Empire – can tell. Interesting guy.

One aspect of the inevitability of this scenario is that it cannot be avoided by tactical, or judgemental supervision or regulation. When the regulators are trying to stop the party in progress they will simply paint themselves as backward, or perhaps spiteful, morons bent on stopping good people from making money. When they prove to have been sadly wise, it is too late to do anything but shoot the worst offenders and bind the wounds of the survivors.

One thing that Soros and Stieglitz agree on is that up to this point the crisis is entirely a collapse of the financial industry. The dicey question is whether that will continue to be the case, or will the imbalances in finance open fissures in the judgements and actions of everyone else. Here the risk is one of a much bigger, if still not “perfect,” storm. Will reverses in Afghanistan, or conflict between India and Pakistan, or some similar rivalry get mixed up in it? Will other agendas, like Al Gore’s desire to stop us all from sweltering to death – though he is not so worried that he has moved out of Tennessee – cause realignments of underlying value that make the difficult chore of sorting out accurate financial value into the impossible task of assigning financial value when actual value is itself undefinable.

The Great Depression is the consummate example of a panic taking place on top of an earthquake. The objective crises, like the rise of Nazi Germany, are well known, but the social turmoil in America are not as well documented. Americans had to ask what kind of America would emerge from the Depression. The social stresses at work today are orders of magnitude larger than the ones at work in the 1930’s. Family disintegration has created – intentionally – a population of self-supporting individuals. A great many of them are going to be disappointed when they lose their jobs. Where is the social safety net that restores not only a part of their income, but that also restores a sense of purpose and acceptance in their lives? We know from the ghetto that welfare can do the first, but only at the cost of reinforcing failure on the second point. The ultimate social safety net, the family and the extended family, are so widely missing.

All of this is too big to get one small mind around, but one implication seems reasonable. FDR, Ronald Reagan, and now Barack Obama faced parallel crises on confidence in the assumptions of American government. FDR and RR were brilliant in the role of restoring confidence on the government. BO seems to have even greater personal skills than they did for precisely this task, but he also is working with much heavier baggage, in the financial bankruptcy of Washington and the ongoing drain of two unpopular wars. If he has the skills of a Reagan, he has the problems of a Nixon. I think he simply must lighten the load. Jettison some deadwood. He seems to understand that imperative very clearly, but every piece of the deadwood is Someone’s pet deadwood.

In a related vein, I think the extremely ambitious budget being voted now, allegedly to finance some sort of recovery, is just a ticking time bomb. I think he would be much better served by following what are his instincts: tell the people that we can’t spend all the dough up front. We need to use it to build a new economy over the next X years (X being approximately 8 years). Forget tax cuts. Don the robes of the pork killer. Make it your dogma that every penny has to be spent wisely on ideas and investments

that will serve the country for the next 50 years. That is what the public wants to hear. Rebuild the railroads. Explore domestically for oil and gas. Change over to nuclear power, with wind and so on as nice frills. Are we doing the right things with garbage, bearing in mind that it always threatens to become a health hazard that threatens the public health and limits the growth and density of urban areas? Etc, etc.

Create new wealth, and infrastructure that supports wealth. This is the bedrock that neither Soros nor Stieglitz seem to see beneath their feet.

There is a deep connection between the financial markets, which are the concern of both Soros and Stieglitz, and the economy where we work and play: between Wall Street and Main Street. The genius of our capital markets is alleged to be their talent for directing investment to its best and highest uses. The uses that I highlighted, and more importantly that Barack and other have highlighted, are the best and highest uses of the saving generated by our national savings, but the capital markets seem to have ignored them. Before we are done, someone has to figure out what went wrong, because otherwise either it is going to keep happening, or we have to fire Wall Street and hire socialism.

I have a suggestion to present on this question, one which has the virtue of confirming my credentials as not-a-socialist. I think Washington has dipped into the pot which is our savings and used the money for its own best and highest purposes.

*4052 Niles Rd.
Saint Joseph, Michigan, 49085
Tel: 269-408-1511
E-mail: jgibbons@logisticresearch.com
Web Site: www.logisticresearch.com*