ADVISOR PERSPECTIVES

A Critical Look at Obama's Economic Team

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October 11, 2011

Confidence Men is an exposé, by the reporter Ron Suskind, of what he claims is incompetence, infighting, and insubordination at the highest levels of economic leadership in the Obama administration during the global financial crisis. Those accusations are largely misdirected. After all, there was no playbook for the administration's economic thinkers to work from – the rapidly unfolding crisis forced them to improvise.

As I interpret the events that unfolded, Obama's initial team of top economic advisers – Larry Summers, Christina Romer, and Timothy Geithner – took great professional and personal risks to protect Obama from himself – that is, from his radicalism and naiveté. The team's relative caution enabled the cure, such as it was, for the crisis to involve a relatively minor expansion of government's role in the economy. Skyrocketing government debt notwithstanding, a much greater expansion of state power could have occurred.

Obama, armed with little more than a citizen's knowledge, was right and his team was wrong on one important issue, as I will explain later on. But for the most part his advisors were giving him sound counsel, even if at times they seemed to be working at cross-purposes with the president.

A much-discussed example of the insubordination described by Suskind is Tim Geithner's alleged failure to prepare and publicize a plan for breaking up Citigroup when the president instructed him to do so. As *Confidence Men* tells it, Geithner believed that public awareness of such a plan would cause depositors and investors to lose confidence in Citigroup, making the potential for the bank's failure a self-fulfilling prophecy. An interesting question is whether a secretary of the Treasury is there solely to execute the will of the president or to use independent judgment. Tradition and a great deal of constitutional interpretation favor the former; by this logic, it was Geithner's job to change the president's mind, not ignore him.

Geithner has been widely quoted as saying that Suskind's account "bears no resemblance to the reality" of the situation, but, at the very least, Suskind's telling of this episode raises a valuable hypothetical question for readers and historians to debate.

Suskind, who made his name as a harsh critic of Bush administration insiders, disdains what he regards as the essentially conservative solutions that the Obama team improvised as the economic crisis unfolded. He, and many other critics of Obama, would have approved if Obama had acted to implement a more vigorously leftist agenda. I, on the other hand, applaud Summers, Geithner, and their colleagues for resisting, to the extent

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they did, the call to "Do Something!" – and for understanding that the risk of doing too much exceeded the risk of doing too little. The principle of "first, do no harm" applies. If what has been done is insufficient, one can always do more; but, once started, a government program is hard to stop, likely to turn into what finance professors call a growing perpetuity, paid by the taxpayers to a army of beneficiaries with special pleadings.

Suskind's title *Confidence Men* indicates he thinks the economic team was made up of flim-flam artists, but I regard them as promoters of confidence in the best sense. The financial system is peculiar and counterintuitive in that confidence in the system, *independent of any other attribute,* helps the system function. Confidence in, say, General Motors does not make a Chevrolet run better, but confidence in JPMorgan Chase does make that bank function better, since depositors will not start a run on a bank that they are sure is solvent. Thus it is entirely appropriate that the first move of Geithner and company in the financial crisis was to bolster public and corporate confidence in the financial system. If they had not done so, through infusions of capital but also through the unfulfilled and unneeded promise of even more support, many more institutions might have failed.

Suskind vacillates between condemning Obama's advisers for insubordination and finding Obama to be out of his depth. In a revealing moment, Larry Summers tells Peter Orszag, with whom he is dining in Washington's Bombay Club, "We're home alone. There's no adult in charge. Clinton would never have made these mistakes." Summers now says that the comment was taken out of context, but the thought has occurred to many observers, from the *New York Times*' Frank Rich on the left to the *National Review*'s Rich Lowry on the right, who feel vindicated by Summers' alleged skepticism about his boss' abilities.

Along the way, Suskind finds that the Obama administration is a hostile workplace for women. For example, he quotes Romer as saying she felt like "a piece of meat" after she had been kept out of a meeting by Summers. The remark is uncharacteristic of the down-to-earth economist and, like Summers, she denies the accuracy of the report, which raises the question of Suskind's own credibility. Among the serious journalists who have questioned the accuracy of Suskind's reporting is Jacob Weisberg, the editor of *Slate*, whose September 22, 2011 review of *Confidence Men* wryly begins, "As an editor, you develop a B.S. meter…" Weisberg goes on to enumerate a great many inaccuracies that he found in the book.

My own B.S. meter did not go off as quickly, because my background as an investment manager does not adapt itself readily to finding the flaws in political analysis. Of course, most of the investment advice that I hear causes the meter to beep on its loudest setting. The lesson here is that political writing, like investment writing, tends to be dominated by authors who use every trick in the book to convince readers that they are getting unbiased information when they are actually getting persuasive, if not openly biased, rhetoric. Readers beware!

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Suskind writes a *lot* of words, by and large well chosen. The book is not a gripping read, but it is a better than passable one, an achievement given the heavy subject matter and often uninspiring main characters. Some of Suskind's background material, particularly his derivatives primer in chapters 3 and 4, displays creativity in explaining difficult economic concepts to lay readers.

Summers is accused by Suskind, and by the left more generally, of being a market fundamentalist, someone who believes that markets can and should function almost completely unregulated by government. Many on the left, however, cannot distinguish a market fundamentalist such as Alan Greenspan – who was a disciple of the radical capitalist philosopher and novelist Ayn Rand – from a centrist, market-friendly Democrat like Summers. Summers has a decent respect for the market, while holding himself out as a wise regulator.

Suskind likewise regards Geithner as a tool of Wall Street because he evidently wants to save it rather than destroy it; thank goodness for that. Geithner never worked on Wall Street for even a day, and (somewhat equivocally) supported mandatory exchange trading of financial derivatives that are currently traded over-the-counter, an action that would have eliminated a large chunk of Wall Street's profits.

Stepping back a bit from the day-to-day decisions and looking at ideology, the most startling fact reported in *Confidence Men* is the uniformity of basic economic assumptions made by the president's top advisers. Some are liberal and some are more conservative, but they are all wholly committed Keynesians – even Summers, who expressed his admiration for the anti-Keynesian economist Milton Friedman in a 2006 article. Obama's economic team acts as though they have never questioned the Harvard/MIT Keynesian orthodoxy that they learned in school.[1] Their actions suggest that they are as sure of their Keynesianism as a team of NASA engineers is of their physics.

But economics is not physics; it is a branch of the study of human behavior, subject to ongoing revision and dispute. Some 43 years after Milton Friedman's presidential address to the American Economic Association, in which he championed free markets and monetarist policy prescriptions, such views occupy about as much bandwidth in the global economics profession as Harvard/MIT Keynesianism. (In many rapidly developing countries, "freshwater economics" – as Friedman's principles have come to be called because of their association with the University of Chicago, is the only kind taken seriously; this, too, is a mistake.) I might have thought Ben Bernanke would be the exception, because of his apprenticeship at Greenspan's Fed, but his wave after wave of "monetary" stimulus is, in practice, a Keynesian policy, seeking to increase aggregate

[1] The "Big Five" economic players in the early Obama administration were Summers (MIT undergrad, Harvard Ph.D.); Romer (William and Mary undergrad, MIT Ph.D.); Geithner (Dartmouth undergrad, Johns Hopkins M.A.); Ben Bernanke (Harvard undergrad, MIT Ph.D.); and Peter Orszag (Princeton undergrad, London School of Economics Ph.D.). Formally, Bernanke is not a member of the administration but he is part of the economic team.

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demand just as Summers, Romer, and others advocated, and disdaining policies that could affect aggregate supply.

Suppose the basic Keynesian structure is wrong? Let us think of taxation as robbing Peter, a taxpayer, to pay Paul, a beneficiary of government spending. Suppose the Keynesian multiplier – the change in aggregate demand, expressed as a multiple of the stimulus – is zero, because robbing Peter to pay Paul has exactly offsetting effects on Peter's and Paul's spending? Suppose the multiplier is negative? (This could happen if a dollar taken away from Peter causes him to save more than the amount by which Paul increases his spending when given Peter's dollar.) If such conditions apply, a better approach than a series of massive stimulus programs would have been to just rescue the payments system in the fall of 2008. (The payments system is that part of the banking system that allows checks and electronic fund transfers to clear and ATMs to provide cash.) Saving this system was an absolute necessity for anyone but the most anti-government fanatic, but policymakers could have then let the market correct the remaining excesses.

We have no modern model for such a laissez-faire policy; the most recent serious attempt to let markets resolve a major economic contraction was in 1920-1921.[2] Interestingly, Christina Romer, a highly capable economic historian, is an expert on this period. After World War I, the U.S. economy entered a sharp contraction comparable in scale to that of 2008. Unemployment soared to at least 8.7% (Romer's estimate) or perhaps even 11.7% (the consumer economist Stanley Lebergott's). President Warren Harding, finding no constitutional authority to intervene in the economy, watched and waited. Harding also cut government spending to match reductions in tax receipts. The turnaround in 1922-1923 was spectacular, and the momentum of the economy's growth continued until 1929. Herbert Hoover could not bring himself to do the same thing in 1929 – he was a passionate interventionist – and we know the unhappy result.

Suskind's tale has a surprise ending. In my view, the best diagnosis of the current economic troubles comes not from a professional economist at all, Republican or Democrat, but from a community organizer and law-school lecturer promoted through the unlikeliest chain of circumstances to the position of CEO for the U.S. government. As Suskind explains, President Obama regards today's very high unemployment rates as the natural consequence of technological change and globalization, wherein low-skilled jobs are simply better done by cheap workers in India, China, and other developing areas, while Americans excel at technical specialties and the manipulation of words and ideas. (The Clinton Administration's labor secretary, Robert Reich, called this latter cadre of knowledge workers "symbolic analysts," a phrase that deserves to stick.) This story harks back to the old, prewar "price of progress" explanation for recessions, and it is essentially correct.

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[2] President Reagan also notably declined to intervene in markets after the crash of 1987, but there was no recession or depression to address.

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Companies that employ technologists and symbolic analysts report a desperate shortage of qualified labor, while those who seek fungible, low-skilled workers report a flood of applicants. (The latter often lack basic skills, such as arithmetic and reading, that were once the path to better-paying supervisory jobs in the old industrial economy.) We thus face a mismatch of titanic proportions between the skills we need and the skills our workforce possesses. Fortunately, this is something that government can help with – if we have the political will to rebuild our public educational system almost from scratch, which is what it would take. Education is the most important shovel-ready project.[3]

The U.S. government's recent policy adventures are misguided. We need to invest public funds judiciously in activities that will increase employment by enhancing our globally competitive position over the very long run, and not attempt quick monetary and fiscal fixes that will be as ineffective as the measures implemented over the last several years. But given the inside-the-box solutions that were likely to emerge from the mainstream, centrist group of economists whom President Obama selected for his initial team, it is foolish and unfair to criticize their actions the way that Suskind does. We need more of those "confidence men," not fewer.

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[3] I would start by giving cash prizes to parents who register their children in the best school district they can find, even if it is out of their legally sanctioned school district, instead of prosecuting them. See http://www.dispatch.com/content/stories/local/2011/09/08/kasich-cuts-convictions-in-mothers-school-case.html.

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