Forbes

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David Brooks and the Meaning Of Greece

It is a problem for me that I am part of a profession that is systematically lying to people.

> Mark Donohoe

As Friday's editorial in the New York Times notes, the current Republican presidential campaign is based on a series of endlessly repeated untruths:

> Mr. Romney's entire campaign rests on a foundation of short, utterly false sound bites. The stimulus failed. (Three million employed people beg to differ.) The auto bailout was a mistake. (Another million jobs.) Spending is out of control. (Spending growth is actually lower than under all modern Republican presidents.) He says these kinds of things so often that millions of Americans believe them to be the truth.

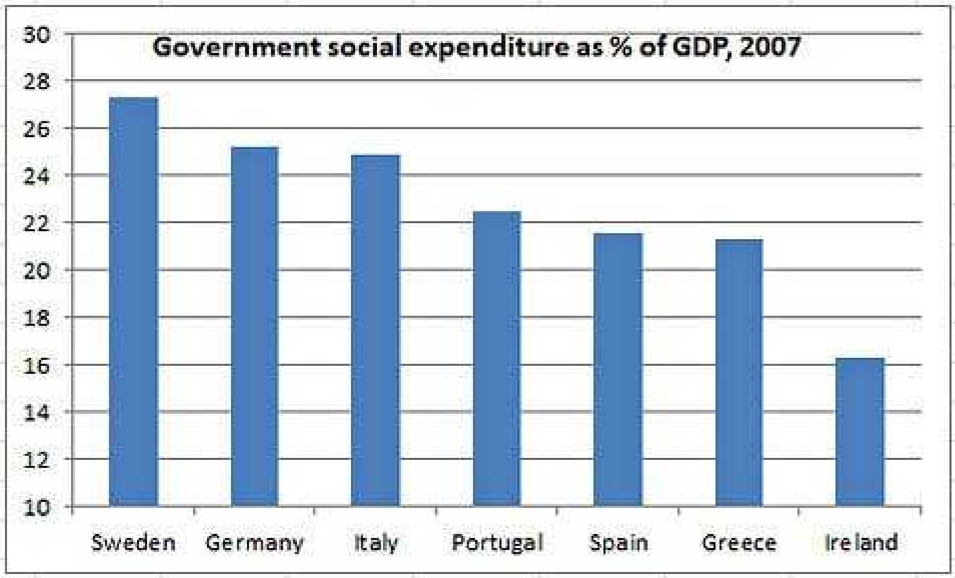
Now, with the slightly encouraging Greek election results continuing the seemingly endless saga of the Euro zone, a big new lie is being peddled by none other than David Brooks: the problems of Europe, and the possibility of a default by Greece and/or other countries, spell "the death throes" of the welfare state in America.

Come again?

As the Center for Economic and Policy Research notes:

> There are a number of problems with this story. First Greece, Spain, and Italy have among the least developed welfare states in Europe. If someone wants to make an argument that there is some inherent problem with the welfare state model then we should look for crises in Sweden, Denmark and Germany, all states with far more generous welfare states than these Mediterranean countries. In fact, the welfare states of northern Europe are doing relatively well through the crisis, it is difficult to understand how anyone can look at the pattern of the crisis across Europe and conclude that it implies that the welfare state model has reached its end.

Paul Krugman cites OECD data showing the share of government social expenditure in GDP.



It’s the countries with the lowest social expenditure that are having the severe problems, not the economies with the high social expenditure.

It’s sad to see David Brooks using the European crisis to lend his voice to the Republican propaganda machine.

The basic problem in Europe: a banking crisis

In the short term, Europe has a banking crisis, not a welfare state crisis. Why does the crisis never get solved? Why is the tiny Greek economy such a big deal? The fundamental immediate problem in Europe is a lack of capital in the banking system, particularly in the shadow banking system. The problem is large in scale: the European banks in total are roughly ten times larger than the US banks in total. It took an infusion of some $200 billion into the banking sector in the US in 2008 to rescue the US banking system. Roughly ten times this amount are needed to put the European banks on a sound footing, i.e. something in the order of two trillion dollars.

The problem is complicated by the fact that the banks are holding sovereign debt from countries like Greece, Spain and Italy. Hence a default of a tiny country like Greece has the potential to cause disruption throughout the whole entire banking system and cause a Lehman-style panic, freezing everything. Already the banking system is partially frozen.

The European governments have had trouble both in facing up to the nature of the problem and in finding the money to solve it. The likelihood of a Greek default or its withdrawal from the Euro zone has little to do with the viability of the welfare state. It’s a failure to address a financial sector crisis in a timely fashion.

The mechanics of selling a big lie

Responding to the financial problems by abolishing the welfare state is similar to responding to an attack from Afghanistan in September 2001 by invading Iraq. Trillions of dollars and tens of thousands of ruined lives later, we are still paying the price for succumbing to that big lie.

The mechanics of a disseminating a big lie should be kept in mind: use a disaster in one area as a pretext to launch a preconceived action in an unconnected area.

A similar big lie is now being attempted by Republicans, with the help of a normally thoughtful commentator like David Brooks: use the unfolding problems in Europe as a pretext for selling a different predetermined agenda: dismantling the social contract that holds the economy and ultimately the country together.

Short-term economic issues in the US

The truth is that the short-term problems of US economy are quite different from Europe's, although the long-term problems have some common characteristics.

In the short term, the US is not currently facing a banking crisis like Europe. It was facing one in 2008, but it was largely resolved by mobilizing several hundred billion dollars of public money. The aftermath of the crisis however is still with us. The result has been, not a recession, but a depression: a prolonged period of slow economic growth and weak job creation that continues while the damage of the housing crisis is being repaired. The short term issue in the US concerns how to deal with the ongoing depression.

In this area, Europe does offer a salutary reminder that sharp cuts in public expenditure makes things worse, not better. As Paul Krugman notes:

> The really decisive evidence on government cuts comes from Europe. Consider the case of Ireland, which has reduced public employment by 28,000 since 2008 — the equivalent, as a share of population, of laying off 1.9 million workers here. These cuts were hailed by conservatives, who predicted great results.
>
> "'The Irish economy is showing encouraging signs of recovery,' declared Alan Reynolds of the Cato Institute in June 2010.

But recovery never came; Irish unemployment is currently more than 14 percent. Ireland's experience shows that austerity in the face of a depressed economy is a terrible mistake to be avoided if possible.

He concludes:

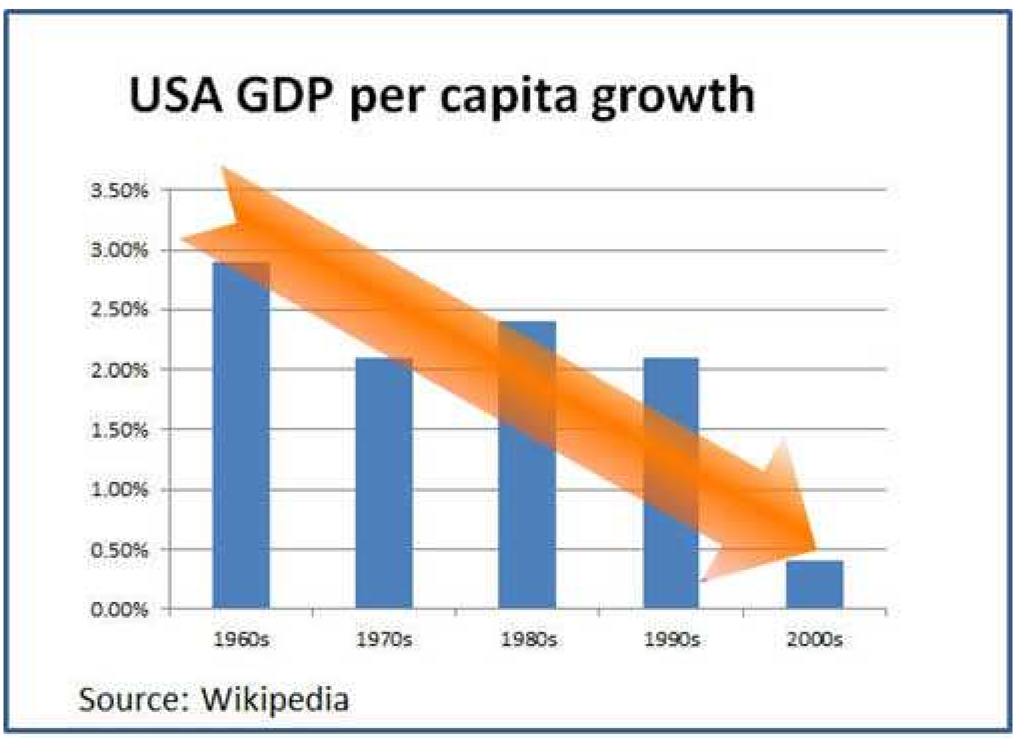
> Over all, the picture for America in 2012 bears a stunning resemblance to the great mistake of 1937, when F.D.R. prematurely slashed spending, sending the U.S. economy — which had actually been recovering fairly fast until that point — into the second leg of the Great Depression.

Further slashing of public funding for maintenance of infrastructure, education and health and for the care of the elderly and the poor will make it both more difficult for the economy to emerge from the ongoing depression and even less able to tackle the longer term structural problems that lie ahead.

In the debate over public sector spending, there is frequent use of the metaphor of a family that has over-spent its budget and must cut back. The metaphor is wrong. The government budget is not like a family budget. It's more like a company investment plan. When a company is in trouble, it may need to make some cuts but the key to the future usually lies in investing more to grow its way out of trouble. Growth solves everything. Systematic government cutbacks as a response to an economic depression are economic nonsense.

The longer-term issue: slowing economic growth

The US and Europe are facing common longer-term structural problem: slowing economic growth. The economy isn't growing fast enough to fund all of the things that need to be funded in a modern economy.



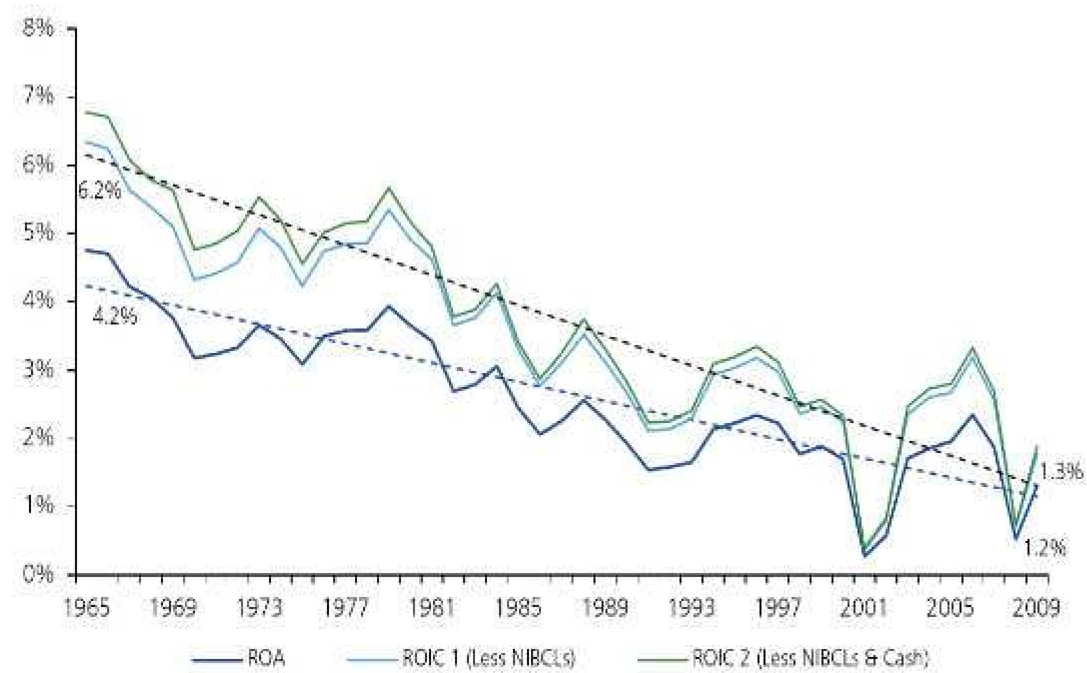
Thus David Brooks is correct to note that the economy is going through a basic change. He quotes the garbled article by Yuval Levin in [The Weekly Standard]() called "Our Age of Anxiety":

> "We have a sense that the economic order we knew in the second half of the 20th century may not be coming back at all — that we have entered a new era for which we have not been well prepared.

This is true. Nobel Prize-winning economist Joe Stiglitz makes essentially the same point in an [important article in Vanity Fair](), It was "absurd to think," says Stiglitz, "that fixing the banking system could by itself restore the economy to health. Bringing the economy back to 'where it was' did nothing to address the underlying problems." The diagnosis of the situation was wrong, argues Stiglitz. It's as if the economic doctors saw the economy as having a temporary disease, like a bout of the flu, when in fact it was suffering from a chronic disease like diabetes that will take years to deal with.

What is not correct is to blame the shortfall in economic growth on the welfare state. The root cause of the problem lies not in the supposed heavy burden of public sector spending, or even excessive regulation, but rather in the ongoing decline of the US private sector as shown by the steady decline of returns on assets and invested capital in the private sector over more than four decades. The massive study by Deloitte's Center for the [Edge]() of 20,000 US firms from 1965 to 2011 shows that the decline has continued through both Republican and Democratic administrations.

Exhibit 6: Economy-wide Return on Invested Capital (ROIC) (1965-2009)

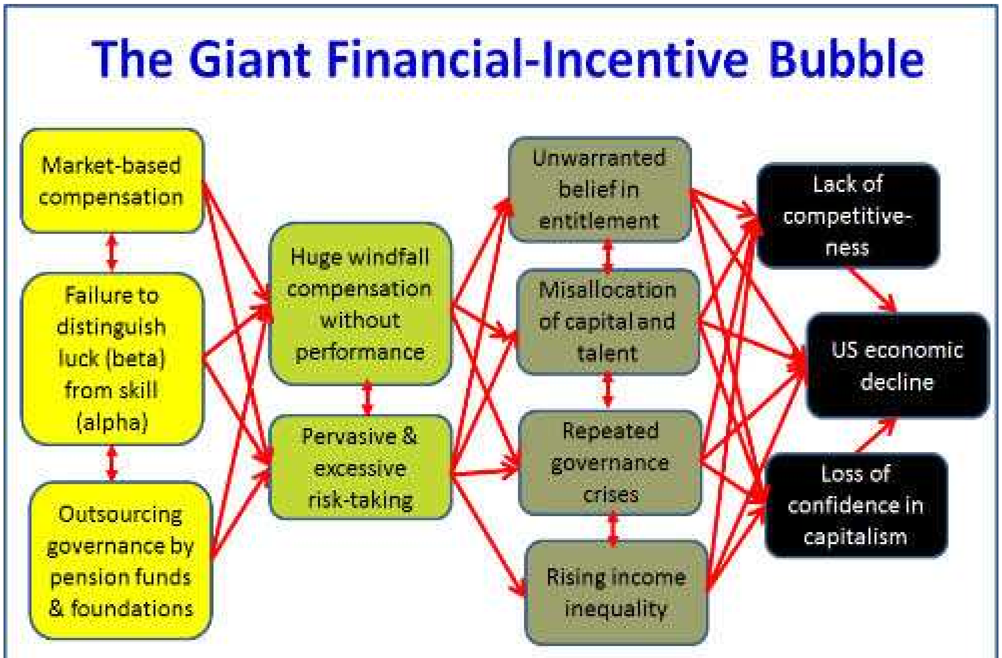


Source: Compustat, Deloitte analysis

The giant financial incentives bubble

The startling decline has two major sources.

One is the over-compensation of the C-Suite. This has created a giant financial-incentives bubble that is draining the real returns to companies and their shareholders. The scale and significance of the over-compensation is described by Professor Mihir Desai, the Mizuho Financial Group Professor of Finance at Harvard Business School in the an article in the April 2012 issue of Harvard Business Review. The overcompensation of the C-suite is not merely an issue of "fairness" or "whining by the 99 percent". The phenomenon is having disastrous *business consequences*, including a serious mis-allocation of capital and talent, repeated governance crises, rising income inequality and an overall decline of the US economy.



Based on Desai, M. "The Incentive Bubble" Harvard Business Review, March 2012

Yet instead of being reined in, C-suite compensation continues to grow apace, as the New York Times reports today.

Although the over-compensation of the C-Suite and the financial sector has now given rise to a false sense of entitlement, it is not sustainable. It causes serious misallocation of capital and talent, repeated governance crises, rising income inequality and contributes to an overall decline of the US economy. It cannot continue, if only because, as Margaret Thatcher used to say in a different context, "Sooner or later you run out of other people's money."

The phase change to the Creative Economy

The other root cause of the decline of the private sector in both the US and Europe is the ongoing phase change from an industrial economy, dominated by big lumbering oligopolistic bureaucracies, to the Creative Economy where the key to success is innovation, agility and the responsiveness to customers.

Most of the firms in the Fortune 500 are ill-equipped to compete in the emerging Creative Economy, in which globalization and the shift in power in the marketplace from seller to buyer have put the customer in charge. Most still have a factory mindset oriented to economies of scale. They are focused principally on maximizing short-term shareholder value. They are not organized for continuous innovation. Their way of managing is unable to mobilize the full creative talents of their employees. Many firms are currently over-capitalized and yet unable to find productive uses for the money in a stagnant economy. So long as these firms stick to the goal of maximizing shareholder returns—which even Jack Welch says is “the dumbest idea in the world”—they will have great difficulty in flourishing in The Creative Economy.

To prosper in the 21st Century, the Fortune 500 must master the management principles needed for continuous innovation that delights customers. The now-prevalent hierarchical bureaucracy is inherently unable to delight anyone–it was never intended to. To delight customers, a radically different kind of management needs to be in place, with a different role for the managers, a different way of coordinating work, a different set of values and a different way of communicating. This is not rocket science. It’s called radical management.

Firms like Apple [AAPL], Amazon [AMZN] or Salesforce [CRM] are showing the way. Those firms that opt not to change won’t survive. The choice is clear: delight or die. Unless and until the private sector as a whole tackles the challenge of the Creative Economy, it will seem as though the country cannot afford to maintain its infrastructure, educate its children, provide health care for its people or care for its elderly citizens.

Incomplete political agendas

While both the Republican and Democratic agenda pay lip service to innovation, neither fully responds to the needed transition.

Mr. Romney’s brand of “innovation” looks dismayingly like the financial capitalism that caused the global crises of the 1920s and 2000s. Ripping apart the social contract by leaving the middle class, the poor and the elderly to fend for themselves, while shredding public expenditure for health care and education, hardly even looks like a good campaign strategy. Moreover if this game plan were to be pursued to its conclusion, it would destroy the social fabric of the country and ultimately its economy.

Here’s a thought: what if Mr. Romney, who claims to have some expertise in management and the private sector, were to wake up tomorrow and lay out a 21st Century strategy for making big business agile rather than merely repeating the policies that have led to the disasters of the past? That would be a campaign speech worth listening to.

Meanwhile President Obama's heart is in the right place, but he often seems too focused on the green economy to recognize that the same hierarchical bureaucracy that is now stifling the private sector is also responsible for the poor performance of the public services over which he presides and the worsening crises in the health and education sectors.

Here's another thought: what if President Obama were to wake up tomorrow and commit the government to fundamental transformation of its management, focused on innovation, agility and the responsiveness to stakeholders? That also would be really good news as well as triumphantly sound politics.

A huge opportunity awaits us

Much of the economic pain that we now feel is an inevitable part of a great economic phase change. While the politicians are mired in the past, the electorate is coming to understand that fundamental change is under way. What is needed now is leadership that focuses on the opportunities offered by the future. We need a clear understanding of the nature of the journey that we are negotiating and intelligent action to get through the transition as quickly and painlessly as possible.

The Creative Economy is a huge opportunity that awaits us. Let's not miss it by succumbing to another big new lie.

And read also:

The Phase Change To The Creative Economy

Should David Brooks Be Blaming Young People

HBR Blows The Lid Off C-Suite Compensation

Resolving the identity crisis of American capitalism

Five surprises of radical management

Steve Denning's most recent book is: The Leader's Guide to Radical Management (Jossey-Bass, 2010).

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