



DILBERT reprinted by permission of United Feature Syndicate, Inc.

it, but there is an almost mystical hope that something good will come of it.”

Based on their study of 30 companies, the authors (he’s a principal at McKinsey & Co.’s London office, she’s a former McKinsey staffer who is now a graduate student at MIT’s Sloan School of Management) argue that the process can pay off in companies that manage it well. The trick is to avoid mounting empty “dog and pony shows” or hoping for brilliant ideas to strike like lightning. The best companies strive to create “prepared minds” rather than formulate concrete plans. “Success is more modestly measured by how well the review helps manage-

ment forge a common understanding of its environment, challenges, opportunities, and economics, thus laying the groundwork for better real-time strategic decision making going forward,” the authors write.

They have a number of other suggestions. For example, strategy sessions should be separated from talk about short-term financial issues, which almost always dominate such discussions. And “those who carry out strategy must also make it.” A strategy concocted by the corporate strategy bureaucracy and outside consultants rather than by business unit heads and other frontline executives is doomed to irrelevance.

The Economics of Imperfection

“Behavioral Macroeconomics and Macroeconomic Behavior” by George A. Akerlof and “Information and the Change in the Paradigm in Economics” by Joseph E. Stiglitz, in *The American Economic Review* (June 2002), 2014 Broadway, Ste. 305, Nashville, Tenn. 37203.

If you were an undergraduate between the 1960s and 1980s, chances are that the name Paul Samuelson rings a bell. An economist at the Massachusetts Institute of Technology, Samuelson was the author of *Economics*, long the most widely used textbook in introductory college economics courses. *Economics* embodied something called “the neoclassical synthesis,” the mainstream doctrine that arose out of the post-World War II effort to reconcile the ideas of John Maynard Keynes and those descended from Adam Smith. The fact that *Economics* is no longer the field’s dominant textbook suggests what has become of the synthesis.

Akerlof and Stiglitz, of the University of California, Berkeley, and Columbia

University’s Graduate School of Business, respectively, shared the Nobel Prize in economics last year (along with Michael Spence) for work that has turned a good part of the economics discipline in a new direction. In their acceptance speeches, reprinted in *The American Economic Review*, they explain what happened.

The neoclassical synthesis—along with its updated successor, the New Classical economics—holds that markets always tend toward “general equilibrium.” Whether the market is for factory workers or candy bars, in other words, supply and demand will eventually reach a perfect, albeit temporary, balance if left to their own devices.

In the real world, of course, that doesn’t

seem to happen, as the theory's proponents themselves have recognized and tried to explain (the Nobel Prize committee has also rewarded their work, as it did Paul Samuelson's before). Akerlof and Stiglitz, however, proposed a more sweeping explanation than these defenders of the synthesis, under the unsexy rubric "asymmetric information." It suggests that economic transactions are powerfully affected by the fact that buyers and sellers—in, for example, the used car market—don't all have the same information. "Information economics" is concerned with teasing out the implications of this fact in a variety of different realms.

One puzzle in the standard theory, for example, is why unemployment exists in the real world. In theory, if workers can't find jobs at, say, a steel plant, they will simply reduce the level of pay they demand until the steelmaker hires them. But in a series of papers during the 1980s, Stiglitz and several collaborators argued that many firms *aren't willing* to hire workers for less. Among the reasons: Lower-paid workers have a higher rate of turnover, which is costly. In such an environment, where wages are artificially high, employers have

only one sanction to apply against workers who perform badly: They can fire them, in effect branding them with information about their performance that makes it difficult for them to get jobs elsewhere. Writes Stiglitz: "We showed that *in equilibrium* there *had* to be unemployment: Unemployment was the discipline device that forced workers to work hard."

Akerlof and Stiglitz believe that information economics can explain many other real-world puzzles: Why do people save too little for their retirement? Why are stock markets so volatile? Why do developing countries experience sudden, severe credit crunches? In a broader sense, Akerlof notes, information economics restores to economics the consideration of psychological and sociological factors that the neoclassical synthesis had driven out.

Yet, as Stiglitz observes, he and his colleagues are still stuck with an equilibrium model of the economy—their work just tries to explain why markets don't reach the perfect balance that theory predicts. He thinks the future lies in a completely different "evolutionary" theory of the economy. Information as to what such a model will look like, however, remains imperfect.

SOCIETY

A Tale of Two Cities

"Murder Mystery" by John Buntin, in *Governing* (June 2002), 1100 Connecticut Ave., N.W., Ste. 1300, Washington, D.C. 20036.

During the 1990s, only two cities—New York and Boston—saw their once-soaring homicide rates fall by double-digit figures year after year. Each city credited its innovative approach to police work, and municipalities elsewhere took note. But the strategies of the two cities were very different, and now they're producing very different results.

"In the past two years," notes Buntin, a *Governing* staff correspondent, "Boston's homicide rate has increased by more than 100 percent," while New York's has continued to fall. "I don't know," boasted Gotham's mayor Rudolph Giuliani in his farewell address to the city last December.

"Which policing theory would you want to follow?"

New York's strategy is based on the "broken windows" thesis that disorder begets crime, so aggressively going after "squeegee men," loiterers, and other minor offenders will reduce the number of more serious crimes. New York also began to track crime trends closely at the precinct level and to press precinct commanders for results. The number of homicides fell from 1,777 in 1995 to 770 in 1997 and 664 in 1999. But the more aggressive policing had a cost: growing tension between police and African American and other minority activists.