THE POLICY SCIENCES CENTER, INC.

Project Director: DR. LLOYD ETHEREDGE
7106 Bells Mill Rd.
Bethesda, MD 20817-1204
Tel: (301)-365-5241
E-mail: lloyd.etheredge@policyscience.net

December 3, 2012

Dr. Philip Sharp, Chair - AAAS Committee on Council Affairs
Dr. William Press, Chair - AAAS Council
1200 New York Ave., NW
Washington, D.C. 20005

Re: The AAAS Accountability Meeting and Vannevar Bush's Design for NSF

Dear Dr. Sharp, Dr. Press, and Council Members:

I write to follow-up my earlier letter concerning NSF breakdowns and to suggest two changes, restoring NSF to the original design specifications of Vannevar Bush and other architects.

Specifically: NSF was designed in the NSF Act of 1950 and amendments to be (in the terms of Civics 101) an independent agency. It was intended solely to make competitive, politically independent, Scientific Merit awards for basic science, based on peer reviews by the nation's research scientists. Its independence and trustworthiness were to be safeguarded by the oversight of an apolitical National Science Board with 24 members, each serving 6-year terms. By law, the first requirement is that "the members shall be *eminent* [italics added] in the fields of the basic, medical, or social sciences, engineering, agriculture, education, research management or public affairs."[1] [2]

1. Restoring the Eminent Scientist Standard

From my perspective in the social sciences, the NSF/NSB leadership is too often lacking stature, statesmanship, political courage, and competence. Restoring the "eminent scientist" standard should secure these qualities in greater degree.

[My perception is that the NSF/NSB system voluntarily surrendered its original scientific integrity and political independence. Beginning 35+ years ago, it constrained NSF social science programs as an accommodation to partisan Republican agendas and to avoid the nuisance of controversy. It became politically "responsive" and built its Other Societal Benefits system as a political marketing device for increased budgets and praise from the new beneficiaries.[3] [4] Next, sensing weakness, less principled members of Congress, interest groups (and even university-administrator interest groups) became more aggressive to undermine Scientific Merit awards, populate the NSF/National Science Board with (less eminent) members, and quietly carve-up the NSF budget without much serious evidence that the diverted funds would accrue to benefits for society.[5]]

2.) "Other Societal Benefits" - The NIH Model

NIH has retained the original (Vannevar Bush) design and this remains the better model for NSF. NIH guarantees the nation's scientists the integrity of an R-01 individual applicant Scientific Merit review and award. Strategic investments and other purposes are assigned to a public, separate and accountable award process (the NIH Director's Fund). Other specialized, applied, and/or marginal programs (e.g., for ties with the pharmaceutical industry) are run by first class people with distinguished advisory committees, with full public accountability and disclosure, to the highest ethical standards.

. - In this decade, as we face many years of budget restrictions for basic research and Scientific Merit funds, I underscore my concern that NSF lacks the expertise to run serious Other Societal Benefits programs. These kinds of goals inherently involve applied social science theories and NSF is not very good at social science.[6] Also: The for-profit sector and sophisticated lobbyists frequently outsmart and buffalo officials like Director Suresh and government bureaucracies. [7] [8] And Leshner *et al.*'s National Science Board oversight Report illustrates how lax the National Science Board has become: Leshner *et al.,* merely reported perceptions of pervasive mismanagement and "confusion" but were not motivated to audit the (doubtful) scientific credibility of the Other Societal Benefits theories and awards. [9]

Restoring NSF to Vannevar Bush's original design by these two steps may not, at this point, fully solve NSF's problems: 1.) Social science research has shown that individuals and in-groups who do not expect to be held personally and publicly accountable for their actions are more likely to compromise moral standards and make lower quality decisions; 2.) The unfairness and damage that have been done to disciplines, programs, and individuals must be addressed honorably.

The AAAS Council: Reversing the Decline of Moral Standards and Stewardship

NSF has hidden its politicization and degree of moral decay by dissembling and misusing the credibility of science and its public image of political independence and peer-review rankings based on Scientific Merit. I will not repeat my civic concerns about the *de facto* secret (and, in this sense, notably dishonest and illegal) censorship of social science in this letter in detail. However, if the topics arise at an Accountability meeting, I enclose further information. It is unacceptable, for example, 1.) that seven leading economists told President Obama more than a year ago that they - given older models and data systems - had run out of good ideas to accelerate economic recovery and Suresh *et al.* continue to restrict fresh thinking and scientific initiatives for rapid learning about economic recoveries and keep their (knowingly) mismatched and conventional historian (without the intellectual self-confidence or training needed to provide urgent leadership) in charge. I also enclose evidence 2.) that federal policy (at NIH) actually supports Scientific Merit studies of racism - i.e., a fact that calls into question Dr. Suresh's morally flawed policies stated by his Assistant Director. [These policies now have a "neither confirm nor deny in writing" status at NSF: Leshner *et al* decided not to discuss Dr. Suresh's racism rules in their public Report]. Leshner *et al.* also were dissembling and evasive about: 3.) the unacceptable political role that Suresh *et al.* continue to play for Republican political suppression in other areas. Specifically, they were silent about when the transformational **Primate Subordination Syndrome** model and a 35+ year Republican empirical claim [repeated in Governor Romney's specific 47% claim about Democrat-supporting Blacks and others] can be tested or even supported by an honorable Scientific Merit review (rather than be pre-screened and killed by an obedient NSF staff.) 4.) Despite blunt warnings from scientific leaders - e.g., former AAAS President Hamburg and the Chair of the Executive Committee of the Harvard Corporation (the economist Robert Reischauer) - the National Science Board continues its traditional practice of stonewalling any honest discussion of its derailed, censored, and eroding social sciences/Economics programs in its published Reports and strategic plans. NSF and the National Science Board deserve to have new leadership that will tell the truth, especially about the Republican-censored and still-neutralized NSF Economics program.

I perceive *hubris*, moral blindness, and stupidity in this Washington-oriented system. I cannot imagine that Dr. Suresh, given his described policies to forbid studies of the effects of racism in the US and abroad, could return to his former position as Dean of Engineering at MIT nor to any administrative position at any research university. There are Black faculty members on our university faculties and Black students and university communities that would view his secret NSF policies as reprehensible. And I see no legitimate justification for Dr. Leshner, in his national positions of public trust on the NSB and with AAAS, to have remained silent about these policies and the transformational and liberating potential of the neuroscience/hierarchical psychodrama paradigm.

Yours truly,

Lloyd Etheredge

Dr. Lloyd S. Etheredge, Director
Government Learning Project

cc: AAAS Section Chairs and Council Delegates

Attachments:

- Letter to Dr. William Press, October 25, 2012 with enclosure "Rutgers Researcher

Exploring Effects of Racism on Immune System."

- Email message to the NSF-SBE Advisory Committee, "Our Nation's Social Scientists Are Smart Enough, With Your Leadership, to Effect a More Rapid Economic Recovery." November 28, 2012 with attachments.

Notes

1. The legal language is online at http://www.nsf.gov/nsb/about/.

2. Other institutions responded to Vannevar Bush *et al.*, with respect for this commitment to a trustworthy, elite Guardianship. For example, neither *Science* nor *The New York Times* Editorial Board will assign investigative journalists to cover breakdowns in the system (unless, in the case of the Times, leaders of major institutions are willing to make a public complaint). Also, there are strong social pressures against individual scientists or disciplines taking criticisms to the press - i.e., with the expectation that issues are responsibly handled behind closed doors.

When sub-systems of the NSF system depart from their original design parameters (e.g., from the eminent scientist standard), other systemic features such as public secrecy can become dysfunctional and accelerate institutional erosion.

3. Today, many members of Congress, once they detect weakness, will press further: "Moreover, many - if not most -of the members of Congress who actively engage in science policy issues are concerned primarily with furthering the interests of specific institutions in their home states or districts." - David Goldston,"Science Policy and the Congress," in Kaye Husbands-Fealing *et al.*, Eds., The Science of Science Policy: A Handbook (Stanford, CA: Stanford University Press, 2011), pp. 327-336 at pp. 328-329. Vannevar Bush and other original drafters were wiser about Congress, and systemic behavior, in 1950 and NSF abandoned the higher, eminent scientist and independence standards at its own risk.

4. Without the stature and courage of truly eminent scientists, there can be problems in other areas. For example: the current Chair of the National Science Board, an administrator and salesman (with an earlier doctorate) whose $900,000/year compensation depends upon a renewable federal contract. It is unlikely that NSB Chairs like Dr. Arvizu have the political courage to allow an NSF rapid test that potentially rejects the Republican perceptions and theory (continuing from President Reagan through Governor Romney) that a clinical dependency syndrome is an induced modal (or near-modal, 47%) feature of American personality structure and motivation underlying many economic and societal problems.

5. For example, our National Science Board in its Investing in the Future: NSF Cost Sharing Policies for a Robust Federal Research Enterprise (Washington, DC: National Science Foundation, 2009) typically abandons data analysis and evidence to give lobbyists and insiders what they want. [The issues included whether institutions like Texas A&M should be expected to put some of their own funds at risk to receive NSF funding for Centers, with industry partners, that allegedly will produce useful innovation; and whether institutions like MIT could voluntarily raise part of the costs for similar projects and have their willingness to put their own

funds at risk count in the competitive evaluation. And whether, once a university had pledged to share costs, it was unreasonably burdensome to require them to keep auditable records so that NSF could know if they had kept their promises.] The National Science Board acknowledged that these issues "always have been controversial," and then (without data analysis or evidence) sought to be persuasive by stating "We firmly believe . . ." , using adjectives like "robust," and signing a unanimous document.

The National Science Board's intellectually and morally flawed work (notably, where money is concerned) is a public embarrassment to the scientific community.

6. When the National Science Board has held-forth about societal processes - e.g., K-12 STEM education - it has defaulted into being a cheerleader and advocate to give billions of dollars to all groups working in this cause. However, a higher scientific advisory body (that has retained the eminent scientist standard), PCAST (the President's Council of Advisers on Science and Technology) actually did its homework and it has compelling evidence that most of the nation's STEM manpower needs can be met if universities use known and inexpensive methods to upgrade the quality of undergraduate science and math education in the first two years: **"Fewer than 40% of students who enter college intending to major in a STEM field complete a STEM degree."** President's Council of Advisers on Science and Technology, Engage to Excel: Producing One Million College Graduates with Degrees in Science, Technology, Engineering, and Mathematics. (2012). Online at http://www.whitehouse.gov/sites/default/files/microsites/ostp/pcast-engage-to-excel-final_2-25-12.pdf " p. i.

7. A recent report in the New York Times shows $80 billion/year in 150,000 awards of tax incentives by states, counties, and cities. However, when interviewed the government agencies involved admit they "do not know if the money was worth it because they rarely track how many jobs are created." See Louise Story, "As Governments Seek Tax Deals, Governments Pay High Price., The New York Times, December 1, 2012. Online.

8. The Institute of Medicine (using several estimation techniques) recently reported $750 million/year of unnecessary services, excessive administrative costs, and fraud and other problems in the American health care system in 2009, including by federal programs. Institute of Medicine, Better Care at Lower Cost: The Path to Continuously Learning Health Care in America. (Washington, DC: National Academies Press, 2012).

9. Leshner *et al* decided what oversight questions *not* to ask - and they decided not to secure data, not to interview NSF officials, and not to hold them publicly accountable for what they actually have been doing and why. Leshner, with his AAAS position, probably had greater standing to challenge the norms of secrecy than most NSF members.

Re: NSF and Racism
[letterhead]
October 25, 2012

Dr. William Press, President and Executive Committee Members
AAAS
1200 New York Ave., NW
Washington, D.C. 20005

Re: Restoring the Eminent Scientist Standard at NSF

Dear Dr. Press and Board Members:

Concerning NSF issues that I have brought to your attention I enclose a press release from the NIH Website, “Rutgers Researcher Exploring Effects of Racism on Immune System.” The New Innovators Award from the NIH Director's Fund honors the research as “exceptionally creative.”

We are slowly realizing how successful the National Science Foundation (across 30+ years and a range of topics) has been to neutralize the dangerous political Left in American social science Departments. By contrast, NIH's award is informative because it refutes the claim that credible political threats and pressures in Washington have compelled the National Science Foundation to kill the study of racism.[1] Rather the problem is the human beings at the top of NSF. NIH's award is from the NIH Director's Fund of Dr. Francis Collins: In the best interest of the country, AAAS should demand personnel changes and restore governance of NSF and appointment to the National Science Board to the “eminent scientist” standard that is sustained at NIH.

NSF's unacceptable behavior also may reflect ignorance. The scientific study of prejudice and racism (and anti-Semitism - e.g., The Authoritarian Personality (1950)) has been a defining accomplishment in the field of social psychology. At current issue is the transformative potential of a new theory of a Primate Subordination Syndrome that, when tested, could illuminate an unrecognized brain mechanism that plays a causal role across an extraordinary range of unsolved and puzzling societal problems of economic, social, and political participation and e/ducational attainment affecting lower-status populations (motivational and cognitive inhibitions, endocrine, health status, and other effects). Yes, this new connect-the-dots theory is bold, but the prediction of a brain adjustment syndrome builds on such prominent scientific accomplishments as Kardiner and Ovesey's The Mark of

Oppression (1951) study of Blacks and induced changes in modal personality (including motivational

and cognitive effects). This pioneering and honored research was cited in the Presidential Initiative of our recent President of the American Psychological Association: I read the book as a graduate student at Yale in the early 1970s and it helped to stimulate my own thinking and political psychology contributions to hierarchical psychodrama models and to propose this new theory.

Yours truly,

/s?

Dr. Lloyd S. Etheredge, Director
International Scientific Networks Project

Attachments: Fredda Sacharow, "Rutgers Researcher Exploring Effects of Racism on Immune System," January 20, 2012. Available online at http://commonfund.nih.gov/news.aspx.

cc: AAAS Council Members and Section Chairs

Rutgers Researcher Exploring Effects of Racism on Immune System:

Professor studying African-American neighborhoods to gauge link between bigotry and body
January 20, 2012. [Downloaded from http://commonfund.nih.gov/news.aspx Science News Around the Nation, 2012, October 5, 2012]

By Fredda Sacharow

Environmental factors in many predominantly African-American communities – neighborhoods fortified with bullet-proof glass and barbed wire, for example, and bus ads aggressively pushing the glories of alcohol -- have long been suspected of playing a role in residents' mental and emotional health.

Now, armed with a $1.5 million grant from the National Institutes of Health, a Rutgers researcher is exploring the effects of multiple layers of racism on an individual's immune system as well.

Naa Oyo Kwate, associate professor in both the Department of Human Ecology in the School of Environmental and Biological Sciences and in the Department of Africana Studies in the School of Arts and Sciences, is leading a team conducting the Black LIFE (Linking Inequality, Feelings, and the Environment) Study.

The NIH Director's New Innovator Award Program, which underwrites what the agency describes as exceptionally creative new investigations, is funding the project.

Kwate's study aims to address two unanswered questions confronting biomedical and behavioral researchers: What effect does racism have on the body, and what can society do about it?

"Most people don't think of racism as a social construct that affects health," says the trained clinical psychologist, who came to Rutgers last year from Columbia University. "They think of behaviors like diet, doctor visits, and the like, not so much about how the broader processes of inequality affect a person's ability to engage in healthy behaviors."

The summer of 2010 found Kwate and her team biking through central Harlem in Manhattan and Bedford-Stuyvesant in Brooklyn, shooting videos with cameras mounted on the handlebars to document signs of institutional racism. They are now coding the videos to identify such features as the retail environment and the proliferation of vacant lots.

The two predominantly African-American neighborhoods were chosen because they are similar in demographics and land-use characteristics. The researchers are interviewing a random sampling of 450 residents about their experiences with racism.

The study will measure the respondants' immune system and metabolic function over two time points through physical tests.

Participants also will be asked whether they've personally experienced racism: Have store managers followed you around, presumably because of the color of your skin? Do cab drivers refuse to pick you up? Responses are expected to provide a record to help the researchers determine to what extent racial discrimination affects psychological and physical wellbeing.

"We're not talking about race in terms of genes, but in terms of what resources and opportunities people have access to," she says. Social factors such as housing conditions and food availability are among the factors contributing to higher levels of diabetes, heart disease, and asthma in predominantly African-American and lower-income urban areas, she notes.

As a follow-up to the interviews and medical tests, Kwate's study will explore a "counter-marketing" campaign designed to help neighborhood residents combat the dangers of internalizing racism's destructive messages.

Although the details have not yet been ironed out, Kwate envisions using outdoor advertising in minority neighborhoods to deliver unembellished facts about American inequality. In the same way that concerted anti-smoking activities of the 1980s and 1990s turned a generation against Big Tobacco, she hopes the billboards will raise consciousness and counter any stressful – potentially deadly -- effects of prejudice.

Kwate's work with the NIH reflects her longtime interest in the psychological and social determinants of African-American health. As an assistant professor at Columbia University, for example, she determined that a higher saturation of alcohol ads in black neighborhoods was associated with 16 percent higher odds of black women being problem drinkers.

In addition to the NIH, backing for her work has come from the U.S. Department of Defense and the Robert Wood Johnson Foundation.

To learn more about Naa Oyo Kwate's research, visit her web site: http://www.rna-lab.com

---

Notes

1. The research also is supported by the Department of Defense.

Date: Wed, 28 Nov 2012 00:56:25 -0500
To: "Dr. AnnaLee Saxenian - Chair, SBE Advisory Committee" <anno@ischool.berkeley.edu>, "Dr. Chris Achen - NSF SBE Advisory Committee" <achen@princeton.edu>, "Dr. Kenneth Bollen - NSF SBE Advisory Committee" <bollen@unc.edu>, "Dr. John Cacioppo - NSF-SBE Advisory Committee" <cacioppo@uchicago.edu>, "Dr. Susan Cutter - SBE Advisory Committee" <scutter@sc.edu>, "Dr. Robert Denham - NSF SBE Advisory Committee" <Robert.Denham@mto.com>, "Dr. Kaye Fealing - NSF SBE Advisory Committee" <khf@umn.edu>, "Dr. Morton Gernsbacher - NSF SBE Advisory Committee" <MAGernsb@wisc.edu>, "Dr. Hilary Hoynes - NSF SBE Advisory Committee" <hwhoynes@ucdavis.edu>, "Dr. Nina Jablonski - NSF SBE Advisory Committee" <ngj2@psu.edu>, "Dr. Robert Kaplan - NSF SBE Advisory Committee" <robert.kaplan@nih.gov>, "Dr. Jon Krosnick" <Krosnick@stanford.edu>, "Dr. Barbara Landau - NSF SBE Advisory Committee" <landau@cogsci.jhu.edu>, "Dr. Emilio Moran - NSF SBE Advisory Committee" <moran@indiana.edu>, "Dr. Miaria (Mia) Ong - NSF SBE Advisory Group" <mia_ong@terc.edu>, "Dr. Stanley Presser - NSF SBE Advisory Committee" <spresser@socy.umd.edu>, "Dr. Steven Ruggles - NSF SBE Advisory Committee" <ruggles.steven@gmail.com>
From: Lloyd Etheredge <lloyd.etheredge@verizon.net>

Subject: NSF-SBE strategy - Re: "Our nation's social scientists are smart enough, with your leadership, to effect a more rapid economic recovery"

Cc: [. . .]
Attachments: Goldfarb.EconomistOutofIdeas.pdf; reischauer.pdf; ChristensenonParadigmUpgrades.pdf;

Dear Dr. Saxenian and Committee Members:

I write to suggest a proposition: "Our nation's social scientists are smart enough, with your leadership, to effect a more rapid economic recovery." If you agree that the proposition might be true, I urge you to take bold and creative steps to test it quickly.

Goldfarb: Eminent Economists are Out of Ideas

A context for this message is the recent attached article by Goldfarb. For my purposes, the gist of the news story is that seven eminent economists told President Obama, more than a year ago, that they were out of good ideas about how to speed the recovery. [There were arguments about one variable, an expensive plan about housing-related debt.] This revelation may not surprise you. However the story codifies a message that puts the challenge squarely before your multi-disciplinary national advisory committee.

Interpreting "Out of Ideas"

- You will recognize that the actual message of the economists must be carefully interpreted: They are out of ideas, *given their models and data systems. . .* As you know, the models are based on highly limited (but often useful) caricatures and the models have, in fact, been eroding (as have the data systems) for more than a decade. [You will recall earlier correspondence about this point, supported by an expert letter from Bob Reischauer.] And economists always have been candid that their models don't work well for "turning point" processes and that major economic shocks activate non-standard "psychological" variables that are not analyzed deeply to identify new kinds of policy implications. There is no compelling scientific evidence that the problem, viewed in a larger framework, actually is hopeless.

The NIH Model

Thus an obvious conclusion: *Let's activate thinking and look further*! This is the standard framework at NIH where "we cannot think of anything else" naturally leads to passionate investigations to discover better causal models and treatments quickly. So - if you are being rational, in your position of stewardship - you should quickly activate your best designs for a rapid learning system! Yes?

If it helps - and perhaps it doesn't - I am confident that I could solve this problem. A simple key is the recognition that you only need usable ideas and variables to effect changes at the margin, across a wide range of different actors in a pluralist system. [I forwarded one estimate (together with the suggestion for an R&D database with samples from the 100 million Mastercard dataset) that we need to shift an average of $50/week/household.] And we have just seen in the election that the Democratic Party itself can mine data and integrate across datasets to effect consequential, new marginal changes in behavior in target groups. Beyond a marginal consumer spending shift, just specify the goal: what percentage shift are you trying to achieve in business investment decisions of companies of different sizes? What marginal shift in expenditures by state and local governments? By investors? By purchasers of what US exports? If you are skeptical about what I could do: Unleash the nation's younger social scientists. Offer prizes - recently, I brought to your attention the $1 million prize offered by Netflix for a 10% shift in a variable . . . and the problem was solved! Would a $10,000 prize work? How much, in light of the revelation in the Goldfarb article, are good ideas worth in the estimate of the NSF-SBE Advisory Committee?

The "P" word

It is reasonable for you to activate a range of strategies, and to explore a full range of disciplines and theories to make the practical connections and marginal changes. As you may have guessed, one model in my mind imagines that the American people have been stunned and scared by a sudden catastrophic failure of trusted institutions - including banks and a federal government that was supposed to be a trusted and knowledgeable regulator and guard against catastrophic events. There has been a deep shock and betrayal made more powerful by the hierarchical psychodrama of a citizen-government relationship. The phenomenon has a powerful added emotional impact that belongs to another realm than the rational calculations that conventional economists believe people should be making based on the value of their houses, alone. Or than is captured by the standard causal theories of consumer confidence measures. Also, the national governing class has not yet restored confidence in its own trustworthy and steady hand - it did not assuredly solve the bank regulation problem and its estimates of a recovery path designed by Larry Summers et al. did not seem fully trustworthy.

Are there predictions and policy implications of these "P" (psychological) variables and theories? Sure: the most useful policy implication is for Republicans and Fox News to shut-up. PBS has a managerial and calm sensibility that has a 2%-3% market penetration, but the perpetual, polarizing, negative election campaign and constant stirring of fear and anger via Fox News (a principal source for news for many more Americans) has - I predict - delayed a faster healing process. [With the campaign over, and the new scare about "fiscal cliffs" possibly being managed to a good outcome, maybe - now - there will be better results]. Let's test the model! We know from the Oklahoma City bombings, and as far back as the Riot Commission panels in the 1960s, that the news media will begin to act more responsibly if there are off-the-record meetings and evidence that they are going too far.

I could give you many plausible ideas and variables to evaluate, and there surely will be many other good ideas that a serious, multi-disciplinary creative process will bring forth. Whatever rapid learning process you design: I suggest that you need to let a creative process develop: if you demand initial plausibility in the economist's paradigm, you can kill a process. If any NSF Assistant Director charges forth to censor research that might reach critical conclusions about Republicans, you can kill the process. Also, if you demand that psychological (or other) insights and ideas come with practical and immediate solutions you can kill the process. Discovery can be a two-stage process: first, for example, you may need to know that the critical problem is a deep and vivid shock related to governing institutes (instead of oddly thinking about the size of household mortgages as the only variable that can shift human behavior at the margin).

<u>Christensen and New "Economic" Variables: Paradigm Refinements</u>

I also enclose a very interesting and promising article by Clay Christensen, a respected and thoughtful researcher and thinker about innovation and business. He distinguishes three types of business investment linked to behavioral decisions of firms and decisions by different types of investors. I think that he is right that you can develop his ideas and shift behavior in useful ways by (in part) using conventional incentives. And if the evidence is good, you might get changes through Congress via the President's State of the Union. Business corporations now have about $2 trillion+ in cash reserves, which they could be spending for new, disruptive technologies with long-term pay-offs. You can start to shift these decisions at the margin, too. Via NSF: Assign the same budget to the problem, and the same social science brainpower, that Democrats invested to win Ohio . . .

NSF-SBE: Rapid Learning System Design

The critical missing ingredient in rapid learning about economic recovery may be at your level: There must be a mechanism to solicit and follow-up good ideas, assemble resources quickly, and evaluate them as if there is a serious and urgent problem that our nation's social scientists are smart enough to answer.

Lloyd Etheredge

Dr. Lloyd S. Etheredge - Director, Government Learning Project
Policy Sciences Center Inc.
c/o 7106 Bells Mill Rd.
Bethesda, MD 20817-1204
URL: www.policyscience.net
301-365-5241 (v); lloyd.etheredge@policyscience.net (email)

[The Policy Sciences Center, Inc. is a public foundation that develops and integrates knowledge and practice to advance human dignity. It was founded by Harold Lasswell, Myres McDougal, and their associates in 1948 in New Haven, CT. Further information about the Policy Sciences Center and its projects, Society, and journal is available at www.policysciences.org.]

Economists, Obama administration at odds over role of mortgage debt in recovery

By Zachary A. Goldfarb, Published: November 22, 2012.NYTimes

One year and one month before President Obama won reelection, he invited seven of the world's top economists to a private meeting in the Oval Office to hear their advice on what do to fix the ailing economy. "I'm not asking you to consider the political feasibility of things," he told them in the previously unreported meeting.

There was a former Federal Reserve vice chairman, a Nobel laureate, one of the world's foremost experts on financial crises and the chief economist of the International Monetary Fund , among others. Nearly all said Obama should introduce a much bigger plan to forgive part of the mortgage debt owed by millions of homeowners who are underwater on their properties.
Obama was reserved in response, but Treasury Secretary Timothy F. Geithner interjected that he didn't think anything of such ambition was possible. "How do we get this done through Congress?" he asked. "What could we actually do that we haven't done?"

The meeting highlighted what today is the biggest disagreement between some of the world's top economists and the Obama administration. The economists say the president could have significantly accelerated the slow economic recovery if he had better addressed the overhang of mortgage debt left when housing prices collapsed. Obama's advisers say that they did all they could on the housing front and that other factors better explain why the recovery has been sluggish.

The question is relevant because although Obama won reelection this month, the vast majority of voters still say the economy is weak and not getting better. Policymakers in Washington are now focused on another type of debt — the public debt all taxpayers owe — but the slow economic recovery, which depresses tax revenue, makes that problem harder to solve.

Nearly 11 million Americans, or more than a fifth of homeowners, are buried in debt, owing more than their properties are worth after piling their life savings into their properties — a persistent and largely unaddressed problem that represents the missing link in what many economists consider the administration's overall strong response to the recession.

"Housing was the neglected piece. They have the kind of attitude that they don't believe this is a good value for the money, this is politically unpopular, and there's not much we can do," said Alan Blinder, a former Federal Reserve vice chairman consulted frequently by the White House. "There were obvious things to do that academics and others started pointing out back in 2008. That could have shortened the recovery time."

Obama's economic advisers dispute that notion. Geithner said the administration chose the best options available to deal with the housing crisis.

"We knew the hit to wealth would be damaging. We knew the level of debt had the potential to restrain the strength of recovery," he said. "The only issue was, what could you do about it? What were the feasible options available? We chose the best of the feasible options."

Obama's advisers believe the ultimate pace of recovery is understandable, if disappointing, given the financial crisis and the collapse in housing prices, as well as surprises such as a drought this year, the European debt crisis, rising oil prices and the trade-disrupting Japanese earthquake. They argue that the course they pursued — spending more than $1 trillion on tax cuts and employment programs — helped all Americans and sped up the recovery, and that alternatives that dealt with housing debt directly were never viable.

Of the original members of Obama's economic crisis team, Geithner, the one still in office, has pressed this point most strongly. Others have said that if the administration did make a big error in its response to the crisis, it had to do with housing.

Lawrence H. Summers, formerly Obama's top economic adviser, has said he doesn't think the administration made a major mistake. But this month, he said at a conference in Washington that "if we made a serious mistake, the best arguments would be around questions about housing."

Former budget director Peter Orszag has said that "a major policy error" was made. And Christina D. Romer, formerly Obama's top economist, has said that the driving ideas "may have been too limited" and that there needs to be a bigger focus on reducing mortgage debt — a process known as "principal reduction."

"The new evidence on the importance of household debt has convinced me that we are likely going to need to help homeowners who are underwater," she said last month. "Many of these troubled loans will need to be renegotiated and the principal reduced if we are going to truly stabilize house prices and get a robust recovery going."

Why debt matters

Some of the most authoritative research on the role of mortgage debt in the recession and recovery — research reviewed by Obama — comes in part from an economist from Pakistan who started out studying why poor countries struggle to grow.

Atif Mian, now a Princeton professor, came to focus on how finance can destabilize an economy. He saw how foreign money had flooded Latin America in the 1980s and Southeast Asia in the 1990s, leading to borrowing booms and financial crises.

Not long before the U.S. recession, Mian and another young economist, Amir Sufi of the University of Chicago's business school, saw a similar trend here. "The common link to the emerging market crises," Mian said, "is that it all starts with leverage."

The two economists compared what happened in U.S. counties where people had amassed huge debts with those where people had borrowed little. It had long been thought that when property values declined in value, homeowners would spend less because they would feel less wealthy.

But Mian and Sufi's research showed something more specific and powerful at work: People who owed huge debts when their home values declined cut back dramatically on buying cars, appliances, furniture and groceries. The more they owed, the less they spent. People with little debt hardly slowed spending at all.

This was important because consumer spending makes up the lion's share of economic activity, and even a small increase or decrease can have a big impact on growth and affect millions of jobs.

From 2006 through 2009, overall consumer spending was flat, according to calculations Sufi completed for The Washington Post. But among the quarter of U.S. counties with the highest debt, it fell 5.5 percent. Without that hit, spending nationwide would have increased by 2.4 percent.

In other words, indebted Americans had an outsize effect, pulling down the rest of the nation's economy.

Some people reduced spending because they had lost their homes to foreclosure, damaging their ability to borrow. Others no longer could tap home-equity lines of credit. Still others, facing high monthly payments, used every extra penny to pay off debt.

When the Federal Reserve greatly lowered interest rates, it helped many borrowers but not those underwater, because banks wouldn't refinance their loans. Federal Reserve data show that the number of Americans paying more than 40 percent of their income toward debt — a high threshold — declined between 2007 and 2010. But among people whose wealth had disappeared, it surged.

Historically, Sufi said, “places that have bigger recessions usually have stronger comebacks.” But his calculations showed that since the end of the recession, places with high levels of debt have not had robust recoveries.

Other economists — from both political parties — were making the same point around the time Obama came to office. Blinder, a Clinton administration official, and Martin Feldstein, a Reagan administration official, developed plans calling on the government to commit hundreds of billions of dollars to restructure millions of mortgages with lower interest rates and principal balances.
Said John Geanakoplos, a Yale economist who proposed a plan to reduce principal: “I think the missed opportunity to forgive principal at the end of 2008 and beginning of the 2009 was the biggest mistake the administration made in trying to deal with the crisis.”

The Obama view

The architects of the Obama administration’s response to the recession — Summers and Geithner — knew all too well the problems of a debt overhang.

The two had begun their public service careers — Geithner at the Treasury Department, Summers at the World Bank — in the shadow of the Latin American debt crisis. A tough-minded rescue plan by Treasury Secretary James A. Baker III had failed and been replaced by a more generous one by Baker’s successor, Nicholas F. Brady, that finally helped Latin America shed its debt.

As Obama took office, Summers would note how the Brady plan had succeeded where the Baker plan failed. But although the new Obama administration had hundreds of billions of dollars in unspent financial bailout money available to use, it decided against any significant program to reduce the debt of underwater homeowners.

“No one was in doubt that debt overhangs were an important problem,” Summers said recently at a conference. But despite exploring many proposals, the administration did not see a plan that did not have the potential to cause “effects worse than the cure,” he said, such as cratering the financial system by forcing banks to absorb huge losses.

At a more basic level, officials simply did not believe that a big program of debt forgiveness was a smart investment, costing hundreds of billions of dollars — money that it preferred to spend on a massive economic stimulus package that could much more quickly lift the economy. The administration also announced a more modest program designed to avert foreclosures by reducing mortgage payments but not the total debt balance.

In late 2009, the economy started to grow at a pace of 4 percent per year — fast enough that employment would have returned to normal by just about now. But in 2010, growth sputtered to 2 percent. The administration responded with more stimulus. But the pattern repeated itself in 2011 and this year.

Today, administration officials say they do not see the mortgage debt overhang primarily at work. Rather, they say, foreign shocks, cuts in local and state spending, and other factors dragged down the economy.

Still, in the past year, Obama has expanded programs to try to better tackle mortgage debt, announcing more federal funding to write down loans and an expanded program to allow underwater homeowners to refinance.

The efforts seem to have had positive effects. A greater number of underwater borrowers have reduced their principle balances and been able to refinance, and the housing market has had a modest recovery.

Not everyone is impressed, though. “I don’t see the kind of aggressive approach that could make a big difference,” Romer said in September at Hofstra University.

Many people still have a long way to return to normal, pre-boom levels of debt. Although Americans racked up $5 trillion in new mortgage debt before the crisis, they have erased only about $1 trillion of it, according to the Federal

Reserve. Research by Karen Dynan of the Brookings Institution shows more than 10 percent of families would have to save all of their income for six months to pay down the debt they accumulated in the boom years.

"The housing sector is far from being out of the woods," Federal Reserve Chairman Ben S. Bernanke said last week. "We should not be satisfied with the progress we have seen so far."

November 3, 2012.NYTimes

A Capitalist's Dilemma, Whoever Wins on Tuesday

By CLAYTON M. CHRISTENSEN

WHATEVER happens on Election Day, Americans will keep asking the same question: When will this economy get better?

In many ways, the answer won't depend on who wins on Tuesday. Anyone who says otherwise is overstating the power of the American president. But if the president doesn't have the power to fix things, who does?

It's not the Federal Reserve. The Fed has been injecting more and more capital into the economy because — at least in theory — capital fuels capitalism. And yet cash hoards in the billions are sitting unused on the pristine balance sheets of Fortune 500 corporations. Billions in capital is also sitting inert and uninvested at private equity funds.

Capitalists seem almost uninterested in capitalism, even as entrepreneurs eager to start companies find that they can't get financing. Businesses and investors sound like the Ancient Mariner, who complained of "Water, water everywhere — nor any drop to drink."

It's a paradox, and at its nexus is what I'll call the Doctrine of New Finance, which is taught with increasingly religious zeal by economists, and at times even by business professors like me who have failed to challenge it. This doctrine embraces measures of profitability that guide capitalists away from investments that can create real economic growth.

Executives and investors might finance three types of innovations with their capital. I'll call the first type "empowering" innovations. These transform complicated and costly products available to a few into simpler, cheaper products available to the many.

The Ford Model T was an empowering innovation, as was the Sony transistor radio. So were the personal computers of I.B.M. and Compaq and online trading at Schwab. A more recent example is cloud computing. It transformed information technology that was previously accessible only to big companies into something that even small companies could afford.

Empowering innovations create jobs, because they require more and more people who can build, distribute, sell and service these products. Empowering investments also use capital — to expand capacity and to finance receivables and inventory.

The second type are "sustaining" innovations. These replace old products with new models. For example, the Toyota Prius hybrid is a marvelous product. But it's not as if every time Toyota sells a Prius, the same customer also buys a Camry. There is a zero-sum aspect to sustaining innovations: They replace yesterday's products with today's products and create few jobs. They keep our economy vibrant — and, in dollars, they account for the most innovation. But they have a neutral effect on economic activity and on capital.

The third type are "efficiency" innovations. These reduce the cost of making and distributing existing products and services. Examples are minimills in steel and Geico in online insurance underwriting. Taken together in an industry, such innovations almost always reduce the net number of jobs, because they streamline processes. But they also preserve many of the remaining jobs — because without them entire companies and industries would disappear in competition against companies abroad that have innovated more efficiently.

Efficiency innovations also emancipate capital. Without them, much of an economy's capital is held captive on balance sheets, with no way to redeploy it as fuel for new, empowering innovations. For example, Toyota's just-in-time production system is an efficiency innovation, letting manufacturers operate with much less capital invested in inventory.

INDUSTRIES typically transition through these three types of innovations. By illustration, the early mainframe computers were so expensive and complicated that only big companies could own and use them. But personal computers were simple and affordable, empowering many more people.

Companies like I.B.M. and Hewlett-Packard had to hire hundreds of thousands of people to make and sell PC's. These companies then designed and made better computers — sustaining innovations — that inspired us to keep buying newer and better products. Finally, companies like Dell made the industry much more efficient. This reduced net employment within the industry, but freed capital that had been used in the supply chain.

Ideally, the three innovations operate in a recurring circle. Empowering innovations are essential for growth because they create new consumption. As long as empowering innovations create more jobs than efficiency innovations eliminate, and as long as the capital that efficiency innovations liberate is invested back into empowering innovations, we keep recessions at bay.

The dials on these three innovations are sensitive. But when they are set correctly, the economy is a magnificent machine.

For significant periods in the last 150 years, America's economy has operated this way. In the seven recoveries from recession between 1948 and 1981, according to the McKinsey Global Institute, the economy returned to its prerecession employment peak in about six months, like clockwork — as if a spray of economic WD-40 had reset the balance on the three types of innovation, prompting a recovery.
In the last three recoveries, however, America's economic engine has emitted sounds we'd never heard before. The 1990 recovery took 15 months, not the typical six, to reach the prerecession peaks of economic performance. After the 2001 recession, it took 39 months to get out of the valley. And now our machine has been grinding for 60 months, trying to hit its prerecession levels — and it's not clear whether, when or how we're going to get there. The economic machine is out of balance and losing its horsepower. But why?

The answer is that efficiency innovations are liberating capital, and in the United States this capital is being reinvested into still more efficiency innovations. In contrast, America is generating many fewer empowering innovations than in the past. We need to reset the balance between empowering and efficiency innovations.

The Doctrine of New Finance helped create this situation. The Republican intellectual George F. Gilder taught us that we should husband resources that are scarce and costly, but can waste resources that are abundant and cheap. When the doctrine emerged in stages between the 1930s and the '50s, capital was relatively scarce in our economy. So we taught our students how to magnify every dollar put into a company, to get the most revenue and profit per dollar of capital deployed. To measure the efficiency of doing this, we redefined profit not as dollars, yen or renminbi, but as ratios like RONA (return on net assets), ROCE (return on capital employed) and I.R.R. (internal rate of return).

Before these new measures, executives and investors used crude concepts like "tons of cash" to describe profitability. The new measures are fractions and give executives more options: They can innovate to add to the numerator of the RONA ratio, but they can also drive down the denominator by driving assets off the balance sheet — through outsourcing. Both routes drive up RONA and ROCE.

Similarly, I.R.R. gives investors more options. It goes up when the time horizon is short. So instead of investing in empowering innovations that pay off in five to eight years, investors can find higher internal rates of return by investing exclusively in quick wins in sustaining and efficiency innovations.

In a way, this mirrors the microeconomic paradox explored in my book "The Innovator's Dilemma," which shows how successful companies can fail by making the "right" decisions in the wrong situations. America today is in a macroeconomic paradox that we might call the capitalist's dilemma. Executives, investors and analysts are doing what is right, from their perspective and according to what they've been taught. Those doctrines were appropriate to the circumstances when first articulated — when capital was scarce.

But we've never taught our apprentices that when capital is abundant and certain new skills are scarce, the same rules are the wrong rules. Continuing to measure the efficiency of capital prevents investment in empowering innovations that would create the new growth we need because it would drive down their RONA, ROCE and I.R.R. It's as if our leaders in Washington, all highly credentialed, are standing on a beach holding their fire hoses full open, pouring more capital into an ocean of capital. We are trying to solve the wrong problem.

Our approach to higher education is exacerbating our problems. Efficiency innovations often add workers with yesterday's skills to the ranks of the unemployed. Empowering innovations, in turn, often change the nature of jobs — creating jobs that can't be filled.

Today, the educational skills necessary to start companies that focus on empowering innovations are scarce. Yet our leaders are wasting education by shoveling out billions in Pell Grants and subsidized loans to students who graduate with skills and majors that employers cannot use.

Is there a solution? It's complicated, but I offer three ideas to seed a productive discussion:

CHANGE THE METRICS We can use capital with abandon now, because it's abundant and cheap. But we can no longer waste education, subsidizing it in fields that offer few jobs. Optimizing return on capital will generate less growth than optimizing return on education.

CHANGE CAPITAL-GAINS TAX RATES Today, tax rates on personal income are progressive — they climb as we make more money. In contrast, there are only two tax rates on investment income. Income from investments that we hold for less than a year is taxed like personal income. But if we hold an investment for one day longer than 365, it is generally taxed at no more than 15 percent.

We should instead make capital gains regressive over time, based upon how long the capital is invested in a company. Taxes on short-term investments should continue to be taxed at personal income rates. But the rate should be reduced the longer the investment is held — so that, for example, tax rates on investments held for five years might be zero — and rates on investments held for eight years might be negative.

Federal tax receipts from capital gains comprise only a tiny percentage of all United States tax revenue. So the near-term impact on the budget will be minimal. But over the longer term, this policy change should have a positive impact on the federal deficit, from taxes paid by companies and their employees that make empowering innovations.

CHANGE THE POLITICS The major political parties are both wrong when it comes to taxing and distributing to the middle class the capital of the wealthiest 1 percent. It's true that some of the richest Americans have been making money with money — investing in efficiency innovations rather than investing to create jobs. They are doing what their professors taught them to do, but times have changed.

If the I.R.S. taxes their wealth away and distributes it to everyone else, it still won't help the economy. Without empowering products and services in our economy, most of this redistribution will be spent buying sustaining innovations — replacing consumption with consumption. We must give the wealthiest an incentive to invest for the long term. This can create growth.

Granted, mine is a simple model, and we face complicated problems. But I hope it helps us and our leaders understand that policies that were once right are now wrong, and that counterintuitive measures might actually work to turn our economy around.

Clayton M. Christensen is a business professor at Harvard and a co-author of “How Will You Measure Your Life?”

THE URBAN INSTITUTE 2100 M STREET, N.W. / WASHINGTON D.C. 20037

ROBERT D. REISCHAUER
President

Direct Dial: 202-261-5400
Fax: 202-223-1335
E-mail: RReischa@ui.urban.org

December 23, 2002

Dr. Lloyd S. Etheredge, Director
Government Learning Project
The Policy Sciences Center, Inc.
P. O. Box 208215
New Haven, CT 06520-8215

Dear Dr. Etheredge:

Thank you for your letter and thoughtful attachment. I am in complete agreement that the economic data we collect has significant deficiencies that limit our ability to understand the economy's problems and chart future policy.

We don't collect some information that is needed and gather much that we could do without. We collect other data in insufficient detail and almost always take too long to release the data for it to be useful in policy decisions.

As you know better than I, there are many reasons for this situation. What we collect and how we collect it reflects the forces at play in the first half of the last century and those forces do not want to give anything up. Congress has little interest in devoting more scarce budget resources to collect new and better information. Few economists who use the data appreciate its limitations. They have been raised on certain data sets and treat them as if they are part of the underlying environment, not subject to change. They put a premium on continuity and don't want discontinuity in the data sets they know and use.

I don't think I would be as critical as you are about CNSTAT/NCR. I don't think they would have much of an impact even if they had done the studies and made the recommendations you think warranted. Nor do I think universities (Yale or Harvard) or the Fed could make much of a dent in the problem. Rather, I think a presidential or congressional study commission is called for—one with a clear mandate and a promise that added resources will be devoted to strengthening the statistical system based on the commission's report. Unfortunately, the prospects for such an initiative rising to the top of policymakers' lists of things to do is very, very low.

Nevertheless, I wish you well in your efforts.

Sincerely,