August 6, 2002

Mr. Dan L. Crippen, Director
Congressional Budget Office
2nd & D St., SW
Washington, DC 20515

Dear Mr. Crippen:

I am concerned by the press reports which indicate that erroneous government economic data from 1999-2001 caused Mr. Greenspan and the Federal Reserve to mis-time policy interventions; and thereby may have contributed to the damage of the recent recession and its continuing effects.

The problem is discussed in more detail in the enclosed correspondence with Dr. Rita Colwell at NSF. I think that CBO will agree that it is unacceptable to have data that are this bad.

- A deeper cause for concern is institutional breakdown and derailment of the good scientific advice that is needed for reliable data and steady improvement in economic forecasts. Our foundation has been concerned by deficient science and supervision at the National Academy of Sciences/National Research Council and NSF, which perform agenda-setting functions for scientific initiatives and also operate the Committee on National Statistics, which is supposed to provide the best intellectual brainpower in the country.

- A fundamental problem with these agencies is that the NAS/NRC has begun to exceed its legal mandate. One issue is that we have argued that NAS/NRC advice should perform an honest broker function, providing fair and reliable evaluations of the ideas (Democrat and Republican) and policies that the government is using to affect economic behavior. Yet the National Academy of Sciences, which received government funds to give its best scientific advice, began in the 1980s to presume a closed-door political role to kill-off, without disclosure to Congress or the public, new research and measures that might anger people with political ideas who could be proven wrong.

We also brought this issue for oversight review in the Executive Branch to the President s Committee of Advisers on Science and Technology (PCAST) in the Clinton Administration. PCAST expressed skepticism about whether our government institutions and the public truly wanted reality-based (v. belief-based) economic and social policy - and by their inaction and message compounded the demoralization and the problem. At the time, Jack Peltason, head of the University of California system, also called senior OSTP officials to express concern about the institutional damage of these practices.

The (allegedly) sophisticated belief by agenda-setting institutions in science that Congress is uninterested in our best scientific advice about reality-based economic policy is surprising, given the bipartisan commitment to an input of accurate numbers and well-informed forecasting represented in the creation of the CBO. Yet, now that demoralization and a climate of tawdriness have set-in, it is difficult for anything to work right, or for any of these institutions to get the leadership and caliber of scientists who should be there to support CBO, the Federal Reserve, Congress, and others

I am enclosing recent correspondence with NSF concerning the technical issues of scientific negligence that affect the quality of data and the ability of social scientists to do their best work to inform public policy discussions and improve forecasting. The historical issues are reviewed in the enclosed testimony to a Commission on Research Integrity; and other documents are on our Website (www.policyscience.net; a References page includes copies of correspondence from the NAS agenda-setting process and PCAST.)

With all best regards,

(Dr.) Lloyd S. Etheredge, Director
Government Learning Project\

cc: Lawrence Lindsey, National Economic Council
Alan Greenspan, Federal Reserve

August 1, 2002

Dr. Rita Colwell, Director
National Science Foundation
4201 Wilson Blvd.
Arlington, VA 22230

Dear Dr. Colwell:

I am forwarding an article from this morning s Financial Times, Data Show US Recession Was More Severe Than First Thought (p. 3) as a supplement to my complaint about deficient scientific standards in macro-economic research. Dr. Bruce Alberts et al. and his predecessor, Dr. Frank Press, have been responsible for the quality and adequacy of these data, through the work of the Committee on National Statistics, which they operate as the agent of NSF. Their standards and results are unacceptable.

Economics is a social science, not rocket science. You do not need a Hubble telescope to acquire data on a cosmic scale, and at a distance of billions of light years; nor do you need to spend hundreds of millions of dollars for super-colliders to study the sub-atomic level. For the most part, the relevant data are readily observable in everyday reality. This makes it peculiar that the latest revisions show errors of at least $100 billion for last year alone, and also that the signs of several key numbers were actually the reverse, in reality, than policy makers, businessmen, and the public were told.

For good public policy, it is essential to forecast reliably. yet (as I wrote to you before these latest revisions) because of the deficiencies of scientific advising via Dr. Alberts et al. our national policymakers cannot trust even simple descriptive statistics. The companion story in today s New York Times notes, for example, that Mr. Greenspan, Chairman of the Federal Reserve, relied on the early descriptive numbers in the spring of 2001 to defend his policies and argue that the country could avoid recession even though, as the reporter notes, we (and Mr. Greenspan) now know that the policies had failed and it is now clear that one had already begun. [1]

- You might want to ask that the alarms by Dr. Paul Krugman also be evaluated. Dr. Krugman, an economist at Princeton (and also a columnist for the Times) has noted that the Japanese Central Bank recently reduced its interest rate to almost zero without any stimulus effect on GDP growth. Dr. Krugman s alarm is that the world may be fundamentally changing. And, as the policy tools based on the work of older macro-economic theorists become ineffective, we should produce a new, reality-based macro-economic theory that the government and public can rely upon, against the day when the economy may be in serious trouble and we need successful public policy.

NSF-supported academic macro-economics has become a peculiar science since: a.) only an a priori set of theory-generated economic variables are allowed to affect economic outcomes - other variables are labeled sociological, psychological, and political and are excluded. It would be better for NSF to achieve a reality-based science - i.e., including the variables that explain the observed outcomes; b.) economics is peculiar, as a social science, because it does not talk to people - i.e., none of the key national measures involve talking to human beings about what they are doing and why;[2] c.) the most honored scientists in the field (to judge from the performance of Dr. Alberts et al.) appear to be oddly indifferent to the reliability of data on which their claims to scientific accomplishment (and their public advice) rest.

In conclusion, may I urge that NSF s senior leadership take Dr. Krugman s warnings seriously? If the world is changing, and we need to invent or identify new policy tools, we cannot only rely upon time-series regression analysis by economists. This is a slow and flawed way to measure changed coefficients because the statistical technique only computes averages across many years. NSF will need new, convergent measures to establish the current value of coefficients that are relevant for public policy.

I will forward a copy of this letter to Dr. Nelson Polsby, a leader in the social science section of AAAS. They also may be able to advise you about institutional reforms that would make social science productive, reliable, self-correcting, and responsive to the interests of the public and the requirements for evidence-based public policy.

With all best wishes,

/s/

(Dr.) Lloyd S. Etheredge, Director
Government Learning Project

cc: Dr. Nelson Polsby
National Science Board
Dr. John Marburger, OSTP

THE AMERICAS: Data show US recession was more severe than first thought

By Peronet Despeignes in Washington

Financial Times; Aug 01, 2002

The US recession last year was more severe than previously reported, government statisticians acknowledged yesterday in a report showing that gross domestic product shrank earlier, faster and over a longer period than first thought.

In raw terms this revision of data from 1999-2001 amounts to an adjustment of about $100bn for last year alone.

The report, released yesterday by the Commerce Department, suggests there was very little growth in US labour productivity last year - contrary to what is widely believed by Alan Greenspan, Federal Reserve chairman, and other policymakers.

The department's revision showed GDP of goods and services shrank in every quarter but the last of 2001 - not just in the third quarter, as previously reported.

It seems to vindicate the declaration of a recession last year by the National Bureau of Economic Research (NBER). The figures show last year's recession began in the first quarter of 2001 and was well entrenched before the September 11 terrorist attacks.

They also show that recession was lifting despite the attacks, suggesting their impact on the recovery was minimal and that the scope for a rebound may now be greater than widely believed.

The report updates 1999-2001 figures showing GDP fell in the first, second and third quarters at an annual rate of 0.6 per cent, 1.6 per cent and 0.3 per cent respectively.

A recession is commonly defined as at least two consecutive quarters of contraction. Previous reports by the department had said GDP last year shrank in only the third quarter - by 1.3 per cent following growth of 1.3 and 0.3 per cent in the first and second - before a 1.7 per cent increase in the fourth.

The revisions show the biggest contraction in GDP occurred in the second quarter - before the terrorist attacks - and that GDP was, in fact, on the verge of growing again in the third quarter despite the attacks.

The changes mean GDP grew only 0.3 per cent in 2001 instead of 1.2 per cent. While mild by historical standards (GDP has shrunk an average 2.3 per cent during previous recessions), it is a big difference.

In an interview yesterday with the Financial Times, Victor Zarnowtitz, a member of the recession-declaring NBER and the Conference Board, said the revisions confirmed his doubts about the reliability of GDP figures. "We didn't use it much as a basis for declaring a recession and rightly so," he said.

"They're the most comprehensive measure of economic activity, but just one measure and too unreliable."

The NBER bases its recession declarations on monthly figures of sales, income, production and employment.

Though the "ramp-up in growth through the latter half of the 1990s" is essentially "unchanged" by the revisions, as the Commerce Department asserts, the story of 2001 is significantly altered.

Labour productivity growth is the difference between growth in output and labour hours, so the 0.9 percentage point drop in estimates of 2001

GDP suggests productivity growth last year was closer to 1 per cent than the previously reported and unusually high 1.9 per cent.

1. David Leonhardt, New Report Shows U. S. Economy Slowed Significantly for Quarter. The New York Times, August 1, 2002, C1, C7.

2. Measures of consumer confidence are created independently via the University of Michigan and a business research group.

Economists claim to have a rational choice theory of decision making, but they do not actually study decision making as a psychologist or other social scientist would do - they do not talk to people about what they are actually doing or why. They simply create a story about the data using the vocabulary of rational choice. And they resort to descriptive/ arithmetic explanations (e.g., GDP is up because business inventory spending is up, and this was greater than the decline in consumer spending.)