

October 31, 2003

Dr. Rex Cowdry, Associate Director
National Economic Council
Old EOB - 17th & PA Ave, NW
Washington, DC 20502

Dear Dr. Cowdry:

Our national capacity for science-based economic policy has eroded to an alarming degree. There is an urgent need for Presidential leadership. The intellectual and institutional breakdowns include the following elements:

1.) All 53 leading macro-economic models (Administration, CBO, private sector/academic) ceased, 18-24 months ago, to give reliable results. There is nothing in their picture of the world to suggest that adding an 18-24 month lag will be a worry-free way to save them. The world is changing and a great deal needs to be rethought.¹

2.) Everybody relies upon the same government data, which are not sufficiently timely or reliable - and the multi-year correction cycle operates too slowly. [For example: it has not been widely reported, but unreliable government data apparently caused the Fed to mistime its policies going into the current recession. Alan Greenspan made speeches for several quarters claiming that the Fed's policies were on track and could prevent a possible recession when we now know from the revised numbers that the economy already had slipped into recession.]^{2 3}

3.) Several government scientific agencies (e.g., NSF, the National Academy of Sciences/National Research Council advisory process, the CEA, and Department of Commerce advisory committees) are supposed to be responsible for fast discovery economics, including new (experimental and prototype) datasets, creative ferment, and competition among ideas. But these agencies are paralyzed by a lack of leadership and capture by a monopoly Establishment of last-generation academic economic theorists who have killed recommendations for new

datasets. The breakdowns have been egregious, and a code of silence has developed by which each agency pretends that it is not responsible for the growing problems and damage to the country, and is not responsible to take the lead to solve the problems.⁴

[The lack of self-correction has been distressing. By contrast, when an airliner crashes, the FAA quickly assembles a team of top experts to diagnose the causes, learn lessons, and implement needed changes - it does not merely hope that everything will be alright.]

- The problems that need urgent attention are partly addressed in the enclosed supporting letter from Dr. Robert Reischauer, a former head of CBO. Dr. Reischauer also is familiar with the institutional problems within the academic world (he is a member of the Executive Committee of Harvard's Board of Overseers). We share the same perception: this is a vital area of scientific progress where President Bush's leadership is needed and our national research universities (and government agencies) cannot resolve the impasse.

I think Dr. Reischauer's recommendation for a Presidential Commission is correct. And the time is right: with the spectacular new GDP growth numbers, the Administration can undertake reforms for future improvement, without implying doubt about the main directions of its policies.⁵

Sincerely,

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

1. The conceptual system is based on steel-plant economics of the 1930s. We use terms like "information age" and "globalization" to recognize several of the important structural changes in economic dynamics, but nobody has worked-out the implications of these changes for upgrading datasets and causal ideas.

I do not doubt that President Bush and his advisers have been doing the best job that they can, given their understanding of the economy. But that is my point: we may be able to get better results, more quickly. And we surely can get better data and earlier warnings to engage needed counter-cyclic policies.

2. Sources and documentation concerning all of these issues are online at www.policyscience.net

3. No CEO or Board of Directors of a major corporation would tolerate a corporate accounting system, for their own decisions, as delayed and unreliable as our national accounting system has become. Our national economic accounting system can do better with modern technology: Wal-Mart has global sales data, by store and individual product, updated and online the next morning. Our banking system handles the transactions of most of the economy, without sampling, reliably and quickly.

For effective monetary policy, we need to forecast reliably at least 9 months in advance, but - today - we can know current reality accurately only 18-36 months after the fact, when the “final” revised estimates (which still may contain errors) are known.

4. Several years ago Alan Greenspan testified to Congress that we are receiving diminishing returns from continually reworking the old, standard and unchanging national economic datasets. The National Association for Business Economics also has made a similar point about the need to rethink assumptions and develop new datasets.

If we widen the behavioral mechanisms that are measured and accepted by the tribes of academic economic Departments, we also are likely to get improved results in foreign policy. As we undertake a “generational commitment” to economic growth and modernization in the Middle East, it is worth noting that the limited set of psychological ideas permitted in academic macroeconomics has worked poorly for economic development policy, with more than \$1 trillion spent for limited effectiveness and tear-gas and demonstrations in the streets of Washington. (Easterly, The Elusive Quest for Growth, MIT Press, 2001). The intellectual insularity of academic economics has not been self-corrected by the Third World failures, either.

5. My only reservation about the Commission idea is that it should not simply contain economists. Part of the scientific problem is that political leaders (and most Americans) have a wider view of human behavior than the orthodox rational-choice/fixed-motivation models of mathematical economics. However when President Reagan and libertarian conservatives have used ideas about dependency and psychological changes in a welfare state - or other behavioral ideas are used in government policy - these causal pathways are not measured and are not included and controlled in the 53 models. Yet regression equations can be highly sensitive to missing variables - the computer programs automatically assign the effects of the ignored variables to the smaller number of included variables, so the computed coefficients can be larger, smaller, or even reversed in sign from their true values. Ego problems and tribal sociology have undermined basic scientific integrity: Ever since Martin Feldstein (head of the CEA under President Reagan) decided to stonewall any measures of “unorthodox” psychological ideas, a growing problem of garbage in results of the 53 standard/orthodox models has been predictable. A Commission needs a wider wisdom about human nature; and it cannot merely adopt a new “quick fix” economic data system for a changing world - we will need to encourage new, experimental, and prototype datasets; scientific competition; and to anticipate a long-term and interdisciplinary process.