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To: "Dr. Baruch Fischhoff - Chair, National Academy of Sciences Study on Social & Behavioral Science and Improving Intelligence for National Security" <baruch@cmu.edu>
From: Lloyd Etheredge lloyd.etheredge@policyscience.net

Subject: Deterring Frankenstein's Monster: Images, Metaphors and Paul Samuelson

Dear Dr. Fischhoff and Colleagues:

The late Paul Samuelson described the world's new financial system as "Frankenstein's Monster." [He said that he was choosing his words carefully.] This is an area for urgent advice by the National Academy of Sciences because we [and Admiral Dennis Blair, who has oversight responsibility for monitoring, modeling, policy advice, and forecasting - including the Treasury Department's Office of Intelligence and Analysis and the CIA's new assignment for global finance/economic analysis] do not yet know what we are dealing with, or what will work.

Images, metaphors, and upgraded capacities to reason by analogy (my earlier message) may be essential. Is the monster self-aware? Does it have a primitive intelligence - or is it run by hardball billionaire strategic geniuses with intercontinental lifestyles, who view profiting from national governments as an exciting and challenging opportunity to outsmart rivals? Or is personification already a misleading image and has Frankenstein's Monster become a complex, adaptive global system where calling any dozen top bankers to the White House for breakfast and rational discussion with the President will be as ineffective as calling such a breakfast meeting with the fantasy that any limited group of human beings could affect whether prices on the global stock market go up or down? How do power and control work in this new world system?

Or was Samuelson misperceiving, and did some people just have a passing episode of binge exuberance during adolescence?

If this is a zero-sum battle for power and money, how do we deter Frankenstein's monster? I spent eight years as a member of the MIT faculty, during the Cold War, when the theory of rational deterrence was to train very smart graduate students in sophisticated doctrines about Mutual Assured Destruction and give them rotary slide rules calibrated in mega-deaths. It is possible that an equivalent deterrence theory is urgently needed: For example, I have appended a copy of Krugman's recent column reviewing the dumbing-down/deregulation strategies that began with the hundreds of millions of dollars that flowed through political consultants and lobbyists (especially to Republicans) to select, back, and elect George W. Bush and an intellectually almost-dysfunctional (Mann & Ornstein, 2008) Congress. The sound-bite theories that more than 100 overly-clever, well-paid, and well-paying lobbyists developed as talking points for Republicans and Fox News are a chilling warning - especially for the DNI - of what a newly wealthy Monster, unwilling to be enchained or domesticated, might also have underway quietly in political systems worldwide.

I do have one simple suggestion:

Admiral Blair should know, candidly, that there is no theoretical or evidence-based agreement among social and behavioral scientists about the evolving nature and complexity of the global financial system; about its political influence here and abroad; about cost-effective remedies of the current global financial crisis; and about the future behavior of the system. Any advice that is reaching the President - for example, from the Department of the Treasury - is not based in data and analysis that the scientific community has seen or is able to verify.

This message needs to get through.

The Treasury Department also needs to review the inherited Bush + Paulson era practice of increasing secrecy. There no longer is a standard of informed consent - and, in a democratic nation with many citizens who have gone to college and who can think about evidence, the government's agenda has simply been consent/acquiescence. Yet these are tough challenges - and we need to be applying our full scientific resources and thinking, together, about what to do. I hope that the National Academy's Report can help us - including our nation's new $75 billion/year intelligence system - to remember the brilliance, the rigor - and the candor and modesty - of Paul Samuelson for the days ahead.

Lloyd Etheredge

The New York Times. December 14, 2009.

Disaster and Denial

By PAUL KRUGMAN

When I first began writing for The Times, I was naïve about many things. But my biggest misconception was this: I actually believed that influential people could be moved by evidence, that they would change their views if events completely refuted their beliefs.

And to be fair, it does happen now and then. I've been highly critical of Alan Greenspan over the years (since long before it was fashionable), but give the former Fed chairman credit: he has admitted that he was wrong about the ability of financial markets to police themselves.

But he's a rare case. Just how rare was demonstrated by what happened last Friday in the House of Representatives, when _ with the meltdown caused by a runaway financial system still fresh in our minds, and the mass unemployment that meltdown caused still very much in evidence _ every single Republican and 27 Democrats voted against a quite modest effort to rein in Wall Street excesses.

Let's recall how we got into our current mess.

America emerged from the Great Depression with a tightly regulated banking system. The regulations worked: the nation was spared major financial crises for almost four decades after World War II. But as the memory of the Depression faded, bankers began to chafe at the restrictions they faced. And politicians, increasingly under the influence of free-market ideology, showed a growing willingness to give bankers what they wanted.

The first big wave of deregulation took place under Ronald Reagan _ and quickly led to disaster, in the form of the savings-and-loan crisis of the 1980s. Taxpayers ended up paying more than 2 percent of G.D.P., the equivalent of around $300 billion today, to clean up the mess.

But the proponents of deregulation were undaunted, and in the decade leading up to the current crisis politicians in both parties bought into the notion that New Deal-era restrictions on bankers were nothing but pointless red tape. In a memorable 2003 incident, top bank regulators staged a photo-op in which they used garden shears and a chainsaw to cut up stacks of paper representing regulations.

And the bankers _ liberated both by legislation that removed traditional restrictions and by the hands-off attitude of regulators who didn't believe in regulation _ responded by dramatically loosening lending standards. The result was a credit boom and a monstrous real estate bubble, followed by the worst economic slump since the Great Depression. Ironically, the effort to contain the crisis required government intervention on a much larger scale than would have been needed to prevent the crisis in the first place: government rescues of troubled institutions, large-scale lending by the Federal Reserve to the private sector, and so on.

Given this history, you might have expected the emergence of a national consensus in favor of restoring more-effective financial regulation, so as to avoid a repeat performance. But you would have been wrong.

Talk to conservatives about the financial crisis and you enter an alternative, bizarro universe in which government bureaucrats, not greedy bankers, caused the meltdown. It's a universe in which government-sponsored lending agencies triggered the crisis, even though private lenders actually made the vast majority of subprime loans. It's a universe in which regulators coerced bankers into making loans to unqualified borrowers, even though only one of the top 25 subprime lenders was subject to the regulations in question.

Oh, and conservatives simply ignore the catastrophe in commercial real estate: in their universe the only bad loans were those made to poor people and members of minority groups, because bad loans to developers of shopping malls and office towers don't fit the narrative.

In part, the prevalence of this narrative reflects the principle enunciated by Upton Sinclair: "It is difficult to get a man to understand something when his salary depends on his not understanding it." As Democrats have pointed out, three days before the House vote on banking reform Republican leaders met with more than 100 financial-industry lobbyists to coordinate strategies. But it also reflects the extent to which the modern Republican Party is committed to a bankrupt ideology, one that won't let it face up to the reality of what happened to the U.S. economy.

So it's up to the Democrats _ and more specifically, since the House has passed its bill, it's up to "centrist" Democrats in the Senate. Are they willing to learn something from the disaster that has overtaken the U.S. economy, and get behind financial reform?

Let's hope so. For one thing is clear: if politicians refuse to learn from the history of the recent financial crisis, they will condemn all of us to repeat it.

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