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July 30, 2003

Dr. Warren Washington, Chair - National Science Board
Dr. Rita Colwell, Director
National Science Foundation
4201 Wilson Blvd.
Arlington, VA 22230

Dear Dr. Washington and Dr. Colwell:

I am writing to renew earlier correspondence about the dangerous erosion of our national capacity for science-based economic policy, a goal for which NSF shares national responsibility for basic science, the design of measurement systems, and fast-discovery initiatives when there are opportunities to improve knowledge.

I enclose a copy of today's column by Robert J. Samuelson in The Washington Post who expresses several of the concerns that I brought to your attention earlier. For example, all of the scientific models of the economy (Administration, CBO, and private sector) have failed for both policy-making and prediction. We have key government datasets that give inconsistent, unreliable, and even opposite pictures ("One problem is that we do not always know which numbers to believe").

Mr. Samuelson writes that - if the models are wrong, the treatment isn't working, and the lab tests are inconsistent and baffling - then the problems of the patient (the economy) "must be worse than suspected." Yet if the models no longer work, an obvious scientific hypothesis is that the world has been changing and that it is the models of the economics profession that "must be worse than suspected."

Samuelson's column reflects a basic human tendency to "wait it out." Although the models have been wrong since 2001, he implies that we should wait longer, hope, and "start worrying" sometime in the future. But this is not good science. Given that the traditional models have failed and that "everyone's guessing," NSF should shift into fast-discovery mode. There is an opportunity for discoveries that could be important to the country. There is no rationale, in the logic of the old macroeconomic models and their picture of the economy, to suppose that adding a new 18- to 24- month time lag could be a legitimate worry-free way to save them.

We also are wasting time. If we want to improve our understanding of the economy during the fall of 2003, we should begin to collect new data in the fall of 2003.

When we are serious about science-based public policy, government agencies move quickly to learn lessons from breakdowns. If an airplane crashes, the FAA moves very quickly, with many experts, to collect necessary data and study the crash - rather than put-off worrying and responding for 2-3 years to see if there are any more crashes. After 9/11 we did not defer action and begin to worry only if there were more terrorist attacks - and Congress demanded an independent inquiry to understand the system-level breakdowns.

Sincerely,

Lloyd S. Etheredge

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

cc: Mr. I. Lewis Libby, Chief of Staff to the Vice President
Dr. Elizabeth Hoffman, National Science Board

Economic Turnaround?
By Robert J. Samuelson
The Washington Post: Wednesday, July 30, 2003; Page A19

On the economy, we're all dunces. There's so much conflicting evidence that almost any story -- hopeful, dismal or in between -- can be told with conviction. You, too, can play Alan Greenspan. Although he's better informed, your story could turn out right. But ignorant as we are, we do know one thing: If the economy doesn't soon improve, then its problems must be worse than suspected.

Imagine the economy as a mildly depressed patient who's receiving some powerful "uppers" (tax cuts, low interest rates, a cheaper currency). If the patient doesn't respond, you know the diagnosis is wrong. It's not just a routine case of the "blahs."

Look at the medication. Tax withholding rates have been reduced. On July 25 the Treasury began sending 25.4 million checks worth $13 billion reflecting the bigger child tax credit. By Sept. 30 (the end of the federal budget year), the tax cut will have pumped $61 billion into the economy, says the congressional Joint Committee on Taxation. Over the following year -- fiscal 2004, shadowing the election cycle -- the estimated amount is $149 billion.

Next, interest rates. From December to June, rates on 30-year fixed mortgages declined from about 6 percent to 5.2 percent. The drop encouraged housing construction, sales and price increases as well as mortgage refinancing. In 2003 mortgage borrowing will total a record $3.3 trillion, up from $2.5 trillion in 2002, estimates economist Douglas Duncan of the Mortgage Bankers Association. About two-thirds of new mortgages involve refinancing (borrowers using new loans to repay old ones with higher rates).

The real estate boom has showered people with "an incredible amount of cash," says Mark Zandi of Economy.com. It arrives three ways: People borrow against higher home values (a "home equity" loan); homeowners refinance old mortgages at greater amounts than the existing debt (a "cash out" refinancing); they sell homes and pocket some of the gain. Altogether, these sources produced $677 billion of cash in 2002, says Zandi. In 2003 the total is running at an annual rate of nearly $800 billion. Whew!

Finally: a cheaper currency. Until recently, the "high dollar" -- compared with other currencies -- penalized U.S. manufacturers. American exports were more expensive, imports cheaper. But since February 2002, the dollar has depreciated 18.5 percent against other major currencies. U.S. exports should rise at a 4.7 percent rate in the third quarter, a 9 percent rate in the fourth, says economist David Huether of the National Association of Manufacturers. This might stop the loss of factory jobs. Could weak auto sales offset the gain? Maybe. But General Motors expects sales to improve later this year and next.

Gosh, the news seems good. People should have ample spending money. After the Iraq war, confidence indicators have increased. So have profits and stocks.

Corporate debt levels have dropped -- a point Greenspan has emphasized -- freeing cash for plant and equipment spending. Why shouldn't the economy get better? Well, here are a few reasons:

• The job market still stinks. This could undermine consumer confidence and spending (though initial weekly unemployment claims recently dropped below 400,000 for the first time since February).

• State and local government tax increases and spending cuts could neutralize some of the federal tax cut. To balance their 2004 budgets, 31 states have cut spending, reports the National Conference of State Legislatures.

• Heavy debts may convince consumers to repay loans rather than increase spending (households devote about 14 percent of disposable income to debt payments, near the recent peak of 14.4 percent).

• Stagnant economies in Europe, Japan and Latin America could dampen exports.

• Rising mortgage rates -- they're up since June -- could slow the refinancing boom and temper (or reverse) home price increases.

• High office vacancy rates and surplus factory capacity could continue to deter business investment in buildings and equipment.

So the evidence is baffling. Still, most forecasters expect better economic growth. It should jump to 3.5 percent to 4 percent in the second half of the year compared with about 1.7 percent in the first half, reports Blue Chip Economic Indicators, a newsletter that follows 53 forecasts. Unfortunately, forecasters have predicted faster growth since early 2002 and, so far, have been wrong. Perhaps this economic cycle has so many unfamiliar features -- the stock "bubble," stagnation in Europe and Japan -- that it has misled forecasters.

One problem is that we don't always know which numbers to believe. Consider jobs. Two government surveys disagree sharply. One asks businesses how many workers are on their payrolls; the other questions households about who's employed. Since early 2001 the payroll survey shows a job loss of 2.6 million; that figure is widely quoted. But the household survey shows a loss of only 108,000 since early 2001 and a gain of 1.9 million over the past year. Most economists trust the payroll survey, but David Wyss of Standard & Poor's thinks the household survey may be more reliable. He suspects that companies have hired "contract" workers who aren't on firms' payrolls but who count themselves as employed.

Who knows? Everyone's guessing. Confusion is the only honest conclusion. We may be on the verge of an economic turnaround, or not. If not, start worrying.