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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: The Global Financial Sector chapter; Krugman's leading-edge concerns

Dear Dr. Fischhoff and Colleagues:

When Dr. Atkinson formed your National Academy study group, he might have been unaware that Admiral Blair's official duties also include independent analysis and secret briefings to the President about international economics and the global financial sector. There is an urgent need for the National Academy of Sciences to include timely advice about these surveillance/data and analysis systems in your Report.

All electronic financial transactions that cross national borders are part of the databanks of the National Security Agency. American under-cover agents and informants began to move into the world's international banks and hedge funds more boldly with Clark Clifford's leadership of BCCI and into US investment banks at least eight years ago. Initially, the focus was on the growing global drug market.

Re financial sector decisions, strategies, and behavior: The DNI system could benefit from scientific advice about developing new models and interpreting its data, which Admiral Blair has ordered the CIA to do.<1>

I am forwarding an article by Paul Krugman (January 15, 2010), a National Academy of Sciences member, that underscores the urgency of good social science based on an integrated analysis across the data systems that are at Admiral Blair's disposal. Krugman scoffs at the public "expert" testimony that we have only been through a "rare accident . . . a 100-year storm" and should not overreact by new regulations. And that "these things happen every 5 to 7 years. . ." However Krugman probably cannot prove his case mathematically. <2> Your Study Group, with expertise in risk assessment, could outline models on which to make an evaluation

of these risk claims alongside other (e.g., predator-prey) models that suggest different policy conclusions.

Lloyd Etheredge

<1> In an earlier message [# 17, 9/25/2009 on www.policyscience.net] I suggested the "who gets what, when, and how" hypothesis that there is a predator-prey relationship developing that is threatening to the US. Admiral Blair and Director Pannetta - with [multi-method] access to emails and cellular telephone intercepts and undercover agents - are in a better position to test such expanded models, and organize intelligence briefings and advice to President Obama and Congress, than economists in academic settings working alone. My hypothesis, and Krugman's analysis, disagree sharply about whether these Titans of Wall Street (and outside the US, who did not testify) are "clueless."

<2> These Titans of Wall Street are smart men who have achieved personal wealth in the hundreds of millions of dollars - and still are being paid at this level - in highly competitive markets. It is not clear that Congress - and especially many Republicans in Congress - will listen to academic scientists like Krugman unless the case can be proven. The political fights may not be settled by such scientific evidence in any case, but compelling evidence that takes opposing arguments seriously could help in the long run, here and abroad. I interpret this testimony as crafted by publicists.

January 15, 2010
Op-Ed Columnist

Bankers Without a Clue

By PAUL KRUGMAN

The official Financial Crisis Inquiry Commission _ the group that aims to hold a modern version of the Pecora hearings of the 1930s, whose investigations set the stage for New Deal bank regulation _ began taking testimony on Wednesday. In its first panel, the commission grilled four major financial-industry honchos. What did we learn?

Well, if you were hoping for a Perry Mason moment _ a scene in which the witness blurts out: “Yes! I admit it! I did it! And I’m glad!” _ the hearing was disappointing. What you got, instead, was witnesses blurting out: “Yes! I admit it! I’m clueless!”

O.K., not in so many words. But the bankers’ testimony showed a stunning failure, even now, to grasp the nature and extent of the current crisis. And that’s important: It tells us that as Congress and the administration try to reform the financial system, they should ignore advice coming from the supposed wise men of Wall Street, who have no wisdom to offer.

Consider what has happened so far: The U.S. economy is still grappling with the consequences of the worst financial crisis since the Great Depression; trillions of dollars of potential income have been lost; the lives of millions have been damaged, in some cases irreparably, by mass unemployment; millions more have seen their savings wiped out; hundreds of thousands, perhaps millions, will lose essential health care because of the combination of job losses and draconian cutbacks by cash-strapped state governments.

And this disaster was entirely self-inflicted. This isn’t like the stagflation of the 1970s, which had a lot to do with soaring oil prices, which were, in turn, the result of political instability in the Middle East. This time we’re in trouble entirely thanks to the dysfunctional nature of our own financial system. Everyone understands this _ everyone, it seems, except the financiers themselves.

There were two moments in Wednesday’s hearing that stood out. One was when Jamie Dimon of JPMorgan Chase declared that a financial crisis is something that “happens every five to seven years. We shouldn’t be surprised.” In short, stuff happens, and that’s just part of life.

But the truth is that the United States managed to avoid major financial crises for half a century after the Pecora hearings were held and Congress enacted major banking reforms. It was only after we forgot those lessons, and dismantled effective regulation, that our financial system went back to being dangerously unstable.

As an aside, it was also startling to hear Mr. Dimon admit that his bank never even considered the possibility of a large decline in home prices, despite widespread warnings that we were in the midst of a monstrous housing bubble.

Still, Mr. Dimon's cluelessness paled beside that of Goldman Sachs's Lloyd Blankfein, who compared the financial crisis to a hurricane nobody could have predicted. Phil Angelides, the commission's chairman, was not amused: The financial crisis, he declared, wasn't an act of God; it resulted from "acts of men and women."

Was Mr. Blankfein just inarticulate? No. He used the same metaphor in his prepared testimony in which he urged Congress not to push too hard for financial reform: "We should resist a response ... that is solely designed around protecting us from the 100-year storm." So this giant financial crisis was just a rare accident, a freak of nature, and we shouldn't overreact.

But there was nothing accidental about the crisis. From the late 1970s on, the American financial system, freed by deregulation and a political climate in which greed was presumed to be good, spun ever further out of control. There were ever-greater rewards _ bonuses beyond the dreams of avarice _ for bankers who could generate big short-term profits. And the way to raise those profits was to pile up ever more debt, both by pushing loans on the public and by taking on ever-higher leverage within the financial industry.

Sooner or later, this runaway system was bound to crash. And if we don't make fundamental changes, it will happen all over again.

Do the bankers really not understand what happened, or are they just talking their self-interest? No matter. As I said, the important thing looking forward is to stop listening to financiers about financial reform.

Wall Street executives will tell you that the financial-reform bill the House passed last month would cripple the economy with overregulation (it's actually quite mild). They'll insist that the tax on bank debt just proposed by the Obama administration is a crude concession to foolish populism. They'll warn that action to tax or otherwise rein in financial-industry compensation is destructive and unjustified.

But what do they know? The answer, as far as I can tell, is: not much.

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