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From: Lloyd Etheredge <lloyd.etheredge@policyscience.net

Subject: 226. Red Team/NAS: Blowing the Whistle on the Financial Crisis Inquiry Report (2011)

Dear Dr. Fischhoff and Colleagues:

From the outside, it is impossible to guess what behavioral theories are believed by the Executive branch and Congress, or by secret organizations like the DNI and CIA in their new assignments to understand global finance and the probability of future crises.

There is a risk that official Reports will be believed. Thus, I write to urge that the National Academy of Sciences quickly recommend a joint Red Team project to challenge the analysis and evidence, and reconsider the recent Final Report of the Financial Crisis Inquiry Commission (2011) - online at www.fcic.gov).

The Commission did not include any members of the National Academy of Sciences, nor any other behavioral scientists. It heard 700 witnesses and the eighty+ staff members reviewed millions of pages of documents to reach conclusions about "domestic and global" causes and

remedies. But the analysis was weak:

General Clapper and Director Panetta et al. should not believe this official Report until they can compare conclusions and policy advice from a Red Team with members of the National Academy of Sciences from all relevant disciplines.

Here are three examples of the new level of rigorous behavioral analysis that General Clapper and Mr. Panetta need to do their jobs::

1.) Losing Contact with Reality - Urgent Explanations?

For example: Although the description may be accurate - “widespread delusions at every level of society” - the causes of such extraordinary - and deeply alarming - human and systemic behavior remain mysterious. [Most of our major institutions are led by people with college degrees!] Until we know why the National Science Foundation and the academic economics profession - for example - lost touch with reality, and did not have dozens of credible econometric models sounding loud warnings, we do not know how to repair these systems, or any of the other systems (e.g., the financial reporting of the Wall Street Journal) that lost contact with reality. [This puzzling phenomenon - “widespread delusions at every level of society” - is an almost irresistible and deeply unnerving breakdown for a good teacher to discuss or to suggest for a term paper or thesis topic - but this important inquiry needs theories and evidence, rigorously compiled, that can call forth competing theories and evidence.]

2.) Systems Produce the Outcomes that they are Designed to Produce

Behavioral scientists will bring new, different, and useful ways to analyze the crisis: The Report adopted the tone of lecturing about failures of civic and moral responsibility. But behavioral scientists are likely to assume that a complex system produced its outcomes because of the design of the system itself. Thus - for example - they will ask about incentive structures at key points within the system and suggest more specific changes.

A. Incentive Structures in Financial Institutions. For example, Dr. Bueno de Mesquita, a member of the Fischhoff study group, should have an opportunity to analyze the changed

incentive structures of the financial institutions. [These are the kinds of actors that his theoretical tradition is ideally suited to analyze.] The old partnership structures - in which all of the major players/owners would eventually lose if their institutions became bankrupt - were replaced by institutions officially owned by (distant) stockholders and that paid (i.e., prepaid) huge salaries and bonuses for risky and risk-shifting behavior. And - globally - foreign investors, especially by using AIG, could shift risks of institutional collapse to American institutions. However: the Report ignored making changes to these incentive and compensation structures, which could be a dangerous omission.

B. Regulators and Stewards. In a system where the ethical restraints normally expected of leaders of major institutions disappeared, the Report's primary reliance upon future outside regulation and moral/civic preaching is problematic. First, behavioral scientists will caution that moral preaching has been used by the Christian Church for 2,000+ years and, even when repeated every Sunday, it is a slow method for improvement - "onward and upward by 2% a century" one historian remarked. Second, the task of creating public regulators and stewards who will have teeth, be sufficiently smart to understand what they are regulating, who will resist expert lobbying and political pressures from both Parties, and who will be independent, tough, and decisive in dealing with institutions that could offer them career opportunities to become fabulously wealthy was - painfully and dangerously - unaddressed by the Report.

3.) Public Systems, facing Global Asymmetries of Brainpower and Money

I will not repeat, here, my earlier theoretical perception of deeper systemic and global causes, unrecognized by the Commission - i.e., the growing asymmetries of brainpower and wealth, and the continuing vulnerabilities of almost all political systems and regulatory systems.

This ought to be a case of learning from a global crisis that our universities and current students are supported to address, with their best work.<1> I urge that a Red Team/National Academy project have the funding that it needs. And that its conclusions - possibly disagreeing with the Commission and allowing for disagreements among the Red Team members - should be published for further public discussion and cumulative learning.

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<1> The DNI should know that NSF has shown no initiative to reallocate funds from the physical science budget to support this work.

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