3/25/2005

Dear Dr. ___________ :

I am writing to request that you and other members of the National Academy of Sciences raise the scientific standards of the economics work done by the NAS/NRC system.

The American people, government agencies, foundations, and the news media rely upon you for agenda-setting advice. Many people, I think, are proud of the continuing leadership of the NAS/NRC system to develop new data systems for evidence-based policy concerning global warming. This contrasts with the lower standard of NAS/NRC advisory work for economics, which has become damaging to the country.

- An alarming set of issues is indicated, compactly, in the following article: The observed reliability of all of the key forecasts for national policy (GDP, government revenue and expenditures, inflation, unemployment, etc.), based on the traditional neo-classical macro-economic model and its national data systems, have eroded across the past eight years. (It also appears that counter-cyclic monetary policy, prior to the recent recession, was mis-timed (and the nation injured) because of unreliable data and theories.) <1> There is a *prima facie* and compelling case that the world is changing - i.e. and the economics profession and other behavioral sciences should shift into fast discovery mode, with new data systems to permit competing theories to be developed and evaluated.

Thus, it is distressing that the NAS/NRC system has aggressively derailed national recommendations for new data systems and paradigm upgrades without a scientific justification - apparently because some senior NAS members in economics do not want to do it. <2> It is difficult to make a case for urgent action if the NAS/NRC system does not support it.

The Academy was created with a <u>civic</u> responsibility to give the best advice of our best scientists, and to keep its own house in order. The reputation of the entire Academy is behind its work. The stagnation/complacency of the economics profession is widely recognized on our campuses. [Their model always has been too limited sociologically and too superficial psychologically.] Neither the credibility of science, nor the American people, nor the reputation of the Academy, are well-served by further tolerance of the pathologies described in Kuhn's <u>The Structure of Scientific Revolutions</u>.

You, too, are a passenger on the <u>Titanic</u>. As a citizen, I think that you would support a vote of "no confidence" in what is going on.

- I also forward a concurring letter from Dr. Robert Reischauer [ignored by Dr. Alberts et al.], an economist and a former head of the Congressional Budget Office and member of the Executive Committee of Harvard's Board of Overseers.

I hope that this matter can be resolved quickly, within the scientific community.

Sincerely,
Lloyd Etheredge

<1> There are additional discussions of these issues on the www.policyscience.net Website.
<2> Recently the National Science Board asked for advice about new infrastructure and data systems for the next decade. About $16 billion of well-prepared and visionary recommendations emerged from the physical sciences. Dr. Alberts et al. appointed a staff liaison for economics and the other behavioral sciences but no major proposals were transmitted.

2/5/2005
Dear Colleagues:

Passengers on the *Titanic* should be warned if navigation and iceberg-warning equipment is malfunctioning and the senior science/engineering staff has decided to stick its head in the sand:

You might be interested in the enclosed article (from February 2004) re the growing credibility gap of the National Science Board/National Science Foundation (and its advisory system) in the area of basic research in economics and our national capacity for evidence-based economic policy. The steady erosion of the nation's macroeconomic forecasting models (including GDP, inflation, and government revenues) began to be dramatically apparent seven years (now, eight) ago.
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White House Forecasts Often Miss The Mark

By Dana Milbank
Washington Post Staff Writer
Tuesday, February 24, 2004; Page A01

President Bush last week caused a stir when he declined to endorse a projection, made by his own Council of Economic Advisers, that the economy would add 2.6 million jobs this year. But that forecast, derided as wildly optimistic, was one of the more modest predictions the administration has made about the economy over the past three years.

Two years ago, the administration forecast that there would be 3.4 million more jobs in 2003 than there were in 2000. And it predicted a budget deficit for fiscal 2004 of $14 billion. The economy ended up losing 1.7 million jobs over that period, and the budget deficit for this year is on course to be $521 billion.

These are not isolated cases. Over three years, the administration has repeatedly and significantly overstated the government's fiscal health and the number of jobs the economy would create, but economists and politicians disagree about why.

The president, though not addressing the predictions directly, regularly points to four events that altered economic expectations: the recession; the Sept. 11, 2001, attacks; the corporate governance scandals; and war in Iraq. "We've been through a lot," Bush said in an economics speech Thursday. "But we acted, here in Washington. I led."

The opposition has sought to portray the economic forecasts as evidence of Bush's dishonesty, similar to the claims of weapons of mass destruction in Iraq that have not materialized. "Every day, this administration's credibility gap grows wider," Sen. John F. Kerry (D-Mass.), the leading prospect to challenge Bush in November, said Friday. "They didn't tell Americans the truth about Iraq. They didn't tell Americans the truth about the economy. And now they're trying to manufacture the 2.6 million manufacturing jobs they've destroyed."

Economists agree that economic forecasts are often unreliable, but they say there is at least one plausible explanation for the discrepancies of recent years: The Bush administration, like the Clinton administration before it and like most private economists, assumed that tax revenue and jobs would rise or fall with the gross domestic product in the same proportions as they had in previous recoveries.

But, because of structural changes in the economy such as soaring gains in productivity, the historical patterns have not held. Job growth and tax receipts were badly underestimated in the boom of the late 1990s, and overestimated since 2000, even as the economy has begun to improve.

Robert D. Reischauer, a former director of the Congressional Budget Office, said that the administration has been "a little exuberant" in its forecasts but that the problem is more a statistical one. "The patterns that prevailed before don't seem to be holding in this current recovery," Reischauer said.

Figures released by the White House show that its overestimate of job creation in 2003 was the largest forecast error made in at least 15 years, and its 2002 underestimate of the deficit was the largest in at least 21 years. But the statistics show that forecast errors began to increase considerably around 1997, under the Clinton administration. By contrast, the Bush administration's GDP forecasts have been relatively accurate, indicating job growth and tax receipts have shed their historical correlation to GDP growth.

"The old theories on predicting revenue proved themselves wildly wrong in the late 1990s and early 2000s," said White House spokesman Trent Duffy. "Nobody saw this happening -- not Wall Street, not Vegas, not Poor Richard, not Nostradamus."

Democrats agree that in 2001, when Congress passed Bush's first tax cut, there was no concrete evidence that there was an unusual decline in tax receipts. But Thomas S. Kahn, Democratic staff director of the House Budget Committee, faults the administration for continuing to rely on upbeat forecasts to pass new tax cuts even after it became obvious there was a problem.

In June 2001, the Treasury Department announced a sharper-than-expected drop in tax revenue. In January 2002, the Congressional Budget Office observed that tax receipts were lower "for reasons that are not entirely understood," and it warned that part of the phenomenon "will remain." The White House Office of Management and Budget, in July 2002, acknowledged that "the precise causes of this year's income tax drop-off will not be known for some time." Yet the administration continued to push for more tax cuts, as Bush promised that the deficit "will be small and short-term."

On employment, the administration continued to make optimistic forecasts even after it became clear that historical patterns were not holding. A year ago, for example, the Council of Economic Advisers predicted that the tax cut package alone that Bush was promoting would generate 510,000 jobs in 2003 and 891,000 in 2004. Even without the tax cut, the council was predicting that average employment would grow by 1.7 million jobs from 2002 to 2003, and 2.7 million jobs between 2003 and 2004.

"They ought to be held accountable for not taking seriously what happened to the jobs numbers," said Lee Price, research director for the Economic Policy Institute, a liberal think tank. Although Bush's jobs forecasts were plausible in 2002, before the extent of productivity gains were known, he said, the continually optimistic jobs forecasts "start to seem outlandish."

The administration used job-creation predictions to justify its 2001 and 2002 tax cuts, as well. In 2002, the economic advisers argued that failure to enact the stimulus package Bush proposed would cost the economy "about 300,000 jobs." The president's economists said that Bush's 2001 tax cuts would create an additional 800,000 jobs by the end of 2002.

In reality, the United States went from an average of 131.9 million jobs in 2001 to 130.4 million in 2002, and to an estimated 130.1 million in 2003. And it will need an extraordinary change to reach the 132.7 million jobs for 2004 that the economic advisers predicted -- the figure Bush declined to endorse.

The administration's budget forecasts have followed a similar pattern. A confident president proclaimed in March 2001: "We can proceed with tax relief without fear of budget deficits, even if the economy softens." About that same time, the administration projected a budget surplus of $281 billion for 2001, $231 billion for 2002, $246 billion for 2003, $268 billion for 2004 and $273 billion for 2005.
Bush has since said that his optimism about budget deficits was based on the assumption that the economy would not hit a "trifecta" of trouble: recession, national emergency and war. But in February 2002 -- after the recession was declared, the terrorist attacks had occurred and war had begun in Afghanistan -- the administration continued to have upbeat predictions. Although it forecast a $106 billion deficit in 2002, it saw the deficit shrinking to $80 billion in 2003, $14 billion in 2004, and becoming a surplus of $61 billion in 2005. Those figures, too, quickly became seen as overly optimistic, as tax receipts continued to come in lower than expected. A year later, in 2003, the administration predicted a deficit of $304 billion for 2003 and $307 billion for 2004. In reality, the 2003 deficit was $375 billion, and the White House now expects a deficit of $521 billion for 2004.

Staff writer Jonathan Weisman contributed to this report.

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