

## PANEL DISCUSSION: OBAMA'S FIRST 100 DAYS AND LESSONS FROM THE GLOBAL CRISIS

FRANCESCO LURATI

*Università della Svizzera italiana*

Thank you. Andrea invited me to contribute to this panel discussion with economists by sharing a communication perspective.

Let me first comment on the term "paradigm" used in the title of the conference. A paradigm is a combination of two dimensions. On the one hand, there is the action dimension, that is, the behavior of people. On the other hand, there is the human-interpretational dimension, that is, what people define as being success factors. A paradigm is formed when behaviors and what are defined as the success factors are aligned and then contribute to the creation of a shared understanding among different constituents about how firms or the economy, in general, create value. It is important to stress that the human-interpretation side is about what the market and the society consider acceptable, and therefore it has to do with expectations.

I would like to address the expectations side of the possible paradigm shift that we are discussing today by mentioning a few data that have characterized the last 15 years of financial euphoria. And I would like to do this by asking if what they represent is acceptable. Is it acceptable that financial assets around the world are about \$160 trillion, 3.5 times the global GDP? If you look at the U.S. data, it is even bigger, 4.5 times. Is it acceptable that the outstanding derivatives around the world are 14 times bigger than the GDP? Is it acceptable that the financial sector has been increasing 2.5 times faster than the overall GDP in the last 15 years? Is it acceptable that 40 percent of corporate profits is formed by financial profits? Is it acceptable that the ratio of household debt to overall household income increased from 60 percent in 1982 to 130 percent in 2007? These are key questions concerning the change in the paradigm because they deal with expectations. Without a definitive (negative) answer, it is difficult to imagine a paradigm shift.

Robert Skidelsky, in his contribution, briefly addressed the changes instituted or launched during the first 100 days of the Obama Administration. I believe that a paradigm shift will happen only if the new Administration is able to modify the understanding of how the financial sector should contribute to the value-creation of a nation.

And here I would like to contradict in part what has been said before concerning the change brought about by Obama. Although I agree that no tangible changes have occurred yet, I think a significant change has been made in terms of how the White House communicates. This is an encouraging sign, since communication plays an important role in changing expectations and therefore in changing the interpretational side of a paradigm as well.

I think that with the Obama Administration we are seeing a move away from a communication approach of fear towards a communication approach of understanding, and I think this is key when you want to change a paradigm. I am just referring to the current crisis. Under the Bush Administration, if you go back and look at press conferences held by Henry Paulson, the communication style was exactly like the one already established by Donald Rumsfeld a few years earlier, that is, fear. There was no attempt to understand or to explain what was going on. With Obama, I think the rhetoric has dramatically changed. It is not about fear, it is about trying to explain. If you go back six days to Obama's speech in Georgetown, both the content and the style were dominated by attempts to answer critics or calm the worries of different stakeholders around the nation and the world. He basically built his speech around that, which is pretty refreshing compared to the previous Administration. There is also an attempt to explain what Obama imagines for the future, a future in which prosperity is fuelled not by excessive debt, recklessness, speculation and fleeting profit, but by skilled productive workers. Core to Obama's thinking is also the

belief that in order to understand how to get there, we first need to understand how we got here. This is also a big change compared to the rhetoric we were used to in the last eight years. In other words, Obama is trying to prepare the field for change by having people build a common interpretation. He wants the different parts of society to “co-orient,” as communication specialists would say.

Now, I fully agree that we don't know what Obama is going to do with this understanding. He has claimed that new rules rewarding drive and innovation will have to be imposed or applied on Wall Street. We don't know what these rules will be, if they will be a Stiglitz-type proposal of a financial-products safety commission (similar to the FDA agency in charge of drug pre-release reviews) or a Paul Davidson approach in which private financial markets are detached from public financial markets. Or the model introduced to us earlier by Richard Werner concerning the GDP transaction and the non-GDP transaction.

A second change introduced by Obama that may have an impact on a paradigm change is the willingness to identify clear responsibilities. With the previous Administration, nobody seemed to be considered responsible for the financial meltdown. Paulson would only “point his finger” at the people opposing his solution. These people were implicitly accused of being unpatriotic and, therefore, “bad” Americans, following the post 9/11 rhetoric. Paulson's focus was to impose his pre-defined view, not to understand what caused the problem. With Obama I think there is an attempt to understand that things are not simple and that there is a collective responsibility. In this regard, I would like to quote a few passages from the Georgetown speech delivered by Obama last week regarding the housing market: *“Instead of saving their pennies to buy their dream house, many Americans found they could take out loans that by traditional standards their incomes could not support. Others [and here Obama is implicitly referring to predatory lending] were tricked into signing these subprime loans by lenders who were trying to make a quick profit [These are pretty tough words]. And the reason these loans were so readily available was that Wall Street saw big profits to be made.”* A few other excerpts from the speech by the new President of the United States complete a lucid and thorough analysis: *“No one really knew what the actual values of these securities were, but since the housing market was booming and prices were rising, banks and investors kept buying and selling them, always passing off the risk to someone else for a greater profit without having to take any of the responsibility.”* And concerning this, he concludes that *“Everybody was making record profits—except the wealth created was real only on paper.”*

I don't think we ever would have heard such words from the people of the previous Administration! One can translate Obama's words as saying that banking and money are special. However, one can also interpret them as an implicit description of a pyramid scheme, a slightly different version of a Ponzi scheme. And if this is the interpretation we give to Obama's words, we should also acknowledge that a lot of people in Wall Street should accompany Madoff to his new home...

But Obama does not see Wall Street as solely responsible. He also clearly blames the American people, who, instead of buying what they could afford with their savings, went for houses that were clearly beyond their financial means. There is, therefore, a collective responsibility shared by all members of the society.

This brings me to my next point—the role played by the media in influencing the behavior of households. Right now the media is struggling to digest what has happened by asking, “Are we responsible?” Some people say “No!” and point to a recent contribution by Chris Roush, “Unheeded Warnings,” published in the *American Journalism Review*, that contains a long list of articles published in the last 10 years denouncing what was going on and predicting what could happen. One may wonder why no one was reading those articles. Politicians were not listening, consumers were not listening, households were not listening. Why? The answer is pretty obvious. Because they were enjoying the party. And when you are in this kind of mood, your attention is very selective. When your stocks and 401(k) are going up, why listen to scarecrows? But this is only one part of the story, the one you hear from those who believe that the media shares none of the responsibility.

Others believe instead that the media is responsible, a view that is also shared by journalists. In fact, a recent study by Abrams Research found that 62 percent of journalists feel they were somewhat responsible in this mess. Along these lines, an interesting idea has been developed recently by the Knight Digital Media Center (an institution co-sponsored by UC Berkeley and the Annenberg School for Communication at the University of Southern California), whereby Robert Nielson points out that good reporting was out there, but too many other news reports played up contrary, obfuscating points of view. And who were these others?

First of all, the cheerleaders. A lot of cheerleading was going on at that time. In this group we found analysts who were regularly being invited to write in newspapers. So much for critical journalism! And then we have an entire television media industry including CNBC, Fox Business Networks, CNN, etc., that is basically a marketing extension of Wall Street. Or channels such as HGTV and Home & Garden TV that specialized, among other things, in instructing American people on how to become rich by flipping houses and leveraging the availability of cheap money. These two typologies of TV played a major role in promoting the deadly financial cocktail that brought us to where we are today. They have proactively shaped Americans' expectations.

Media have, therefore, a major role to play in the making of a new paradigm. A clear unbalance is visible today. The media that have embraced an activist approach belong to the group that has steered an entire nation into a collective, speculative frenzy. The most progressive media, such as the *Washington Post* and the *New York Times*, instead, have not been able to counterbalance this influence. The problem with them is that they are still functioning according to the old journalism paradigm in which news and opinions are exposed in a balanced way, letting the audience make up its mind. Today, the audience is more attracted to strong ideas delivered through narrowcasting channels, such as blogs or specialized TV channels. The progressive and "intelligent" media have to learn the new way of journalism if they are to play a role in shaping a new economic and societal paradigm. And, incidentally, as pointed out by the Knight Center, this will also help them not to disappear.

Having said that, we are all aware that the major obstacle to such a change is *advertising*. Advertising, as we all know, is the lubricant of commerce, but it can also be the main obstacle to "intelligent" media and therefore to the free formation of expectations and, eventually, to democracy.

So, these are a few "communication" insights into a very complex discussion about the economy and its future.

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RICHARD WERNER

*University of Southampton and ProfitFund*

I think this is a fascinating discussion and before I answer your question, if I may just make a few remarks about how I think this is extremely well linked to Francesco's comments and also to the earlier discussion we had at the end of Lord Skidelsky's points about expectations. In fact, Francesco ended with the words that expectations are created, and this is also what I found in my empirical work: there is a lot of manufacturing of expectations going on. In other words, we are talking about manipulating people and their actions, which is why I am cautious when we talk about expectations. I didn't mention the word expectations in my presentation because, just as I think also Lord Skidelsky feels, I disagree with the mainstream misuse of the concept, and the use of expectations in their models, and that's one reason why I am very cautious. There is a misuse of the concept of rational expectations, but actually even the concept of adaptive expectations, and other formalizations, is potentially not helpful. There is one fact about expectations: virtually by definition, as the cycle turns they are wrong. We know about the realities, which Keynes also described very well, whether it's a beauty contest type of thing or herd behavior, but

in our search for a correct theory of the macroeconomy, expectations which are wrong can't be all that useful, right? We need ingredients that give us a correct explanation about what is happening with the economy. Simplicity beats complexity, and here again, like Lord Skidelsky, I am against this overuse of mathematics, which is really a way of saying, "Oh, it's got to be complex to be true," when, in my experience and in empirical experience, the truth is quite simple. If we agree that there is no empirical evidence that a theory of expectations can even be formulated, perhaps we shouldn't use it. There is also another reason, and I think Lord Skidelsky would agree, that the use of expectations has been a problem with bad economics, because whenever there is a gap between a theory and reality it has been easy for the economist to say, "Ah, the difference you see is not invalidating or contradicting my theory, the difference is expectations," because, conveniently, we cannot measure them. There has been a fudge in economics, and that is something we should discourage. Aside from saying that there is uncertainty, and these are also the words of Lord Skidelsky, do we need another theory of expectations? Because I'm arguing that there is imperfect information, which is why there is no equilibrium; you need perfect information for equilibrium, and that is how you get this equilibrium economics.

Referring again to Francesco's comments, I have also had some experience with journalists and have an anecdote for the audience. I started out as a purely academic economist in various research institutes at Oxford and in Tokyo. Then I took a job as chief economist at Jardine Fleming Securities in Tokyo, and one thing that changed dramatically was the number of times I was cited and interviewed by journalists. When I gave up the job years later, the media were no longer interested. I spoke to some journalists about that, and it seems to be an editorial policy of what Noam Chomsky would call the "corporate media," because media are also large-scale corporations with certain interests. Two, there is an explicit policy to interview analysts and economists at the large mainstream financial institutions and get their views into the newspapers. As in Francesco's example, they can even write articles. Yes, I once wrote a half-page article for the Nikkei financial newspaper when I was at Jardine Fleming. Afterwards that was much harder to do.

The system seems to like this sort of thing. I was also shocked by the "Flip That House" show when I came from Japan to the U.K. in 2004 because it was a *déjà vu*. Switch on the telly, and you see all these programs on all the channels about how to do up your house, sell it on, buy another house, cleverly put in a bit of money, sell on at a profit, the market is going up, get a mortgage. There were details on how to do that everywhere, and half of the newspapers were real-estate advertisements. It was so obvious what was going on.

I would like to return to one of the previous points of my presentation. It seems the system likes cycles because there are so many incentives in there that make this quite attractive. One can apply this to the central banks, using the inductive methodology: Central banks claim that their job is to create stability of prices, growth and currencies. However, I am very suspicious because, where is the empirical evidence? An alternative hypothesis is supported by the fact you can actually read in central bank publications that crises are good, crises are useful. The Bank of Japan has said the crisis is actually helping Japan to engineer structural change and change the political system. If the alternative hypothesis is that the job of central banks is to create cycles, we actually find a lot of empirical evidence. That is the brief answer to the question "Is there too much finance in the world?" Yes, obviously there is, there is too much speculative credit creation, and casino capitalism is therefore the result. I envisage as a solution that this be restricted. The qualitative use of credit is key, and methods to directly control and direct credit have worked extremely well. This is the core of the East Asian economic miracle which is based on that concept. Incidentally, there is also another answer to one of the points raised by Lord Skidelsky when, before Keynes had published his 1936 general theory, Germany and Japan were in full employment, which was based on a credit creation approach, which was a sort of branch of the earlier Keynes, if you will.

Thank you very much.

SCOTT FULLWILER  
*Wartburg College*

Some of you might know Robert Shiller, who has written some of the better books on bubbles, first on the stock market bubble and then on the U.S. and real estate. I think you should be one of the people he looks up when he does his next book because of course he's going into cultural and sociological factors that are driving expectations.

I have a quick point, an interesting story regarding rational expectations. When I was in the job market about nine years ago, I was interviewing at one of the top five liberal arts colleges. I was being shown around by someone who had a Ph.D. from Chicago, and I asked him, "So, what do you think about rational expectations?" This of course was when the stock market was at its peak, etc., and he replied, "It's wrong, it's completely wrong, 100 percent wrong, there is no way that it is correct. Having said that, it is the only possible way to model expectations." That's what we are dealing with. I thought that was a pretty good point. I left expectations out of my presentation on purpose because Lord Skidelsky is on the panel and I figured he would talk about it, and the second reason is that Lord Skidelsky is on the panel and I didn't want to say something stupid about Keynes. However, I would say that the process Francesco was talking about is absolutely driven by expectations because the only margin of safety you had on a lot of these real estate loans and securities was the underlying collateral. If you didn't have an expectation that the value of that collateral was going to increase, why would you have been making the loan or buying the security in the first place? I am not saying rational expectations are correct, but I am saying there are expectations. Now, I am not giving up just yet on the mathematical modeling of expectations because I don't know what the future holds, that's my expectation I guess. But I think of advances in complexity theory, complex systems theory, etc.: if you had some reasonable assumptions that we actually live in a nonlinear world, that we live in a world where people's expectations are not correct, we live in a world where macroeconomics matters and macro effects on financial statements matter, and there are some people doing what they call agent-based modeling which throws in a lot of different types of agents with different types of expectations... I don't know that they've gotten anywhere yet that bears the sort of fruit you are looking for, but I'm not going to say that they never will. I do think one of the problems they have is that they have no macro-models yet that are stock-flow consistent.

Lastly, addressing the question, "Is there too much finance?" Of course we have been talking about Keynes and financial vs. industrial circulation. I think that before Keynes, Veblen had a very similar concept. In terms of restricting credit creation, we've tried some things in the past. One was the gold standard, which didn't work out too well because when you have a gold standard you restrict credit creation but you also restrict employment and all sorts of other things to the quantity of gold. So we went in a different direction, where we had a fiat currency and we didn't restrict credit creation, and now we see where we are. So, I would say I prefer a fiat currency like we had but I also favor the sort of regulation that you have been talking about, that Minsky talks about, and so forth. So, yes, there is too much finance, but even though there are a lot of folks talking about the gold standard now, particularly in the U.S., we obviously got rid of it because it didn't work so well.

That would be the end of my statement.

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LORD ROBERT SKIDELSKY  
*University of Warwick*

With regard to finance, I think there is too much. I think finance is a handmaid and should not be the master. I was on a panel with Robert Shiller quite recently, and he was talking about the Shiller model for pricing futures in the housing market. I said I want deinnovation in finance, not innovation, deinnovation. I want simpler, simpler finance, and he looked puzzled and said, "Oh, I'll have to think about that" as he saw his model being threatened, because he wanted to develop it to make the housing market more secure.

There are a lot of people who have very good insights but are completely ignored by the economics profession. I am thinking of George Soros, who has written five books, but he's not rated. Why? Because he is not a professional economist. The validity of his insights, the fact he is extremely successful in testing his theories with the Quantum Hedge Fund doesn't count at all. He doesn't have a model and he doesn't use maths. Taleb, black swan, randomness, good statistician, he's never been cited in any economics book I've read recently, discussing some of the same things.

Use of language, I think is very important. Consider the linguistic imperialism of economists: they appropriate words which we think have one meaning and then twist them to their own meaning and then you can't use those words in any other way again. Rationality: belief in models devised by Chicago economists; irrationality: belief in anything else. It's true. Even Shiller, whom I have a lot of time for, Shiller and Akerlof recently wrote a book called *Animal Spirit* in which they define as irrational all the things that a lot of people would call rational, rational in terms of the world in which they live. Keynes did not believe in irrationality as the most important principle, he believed in rationality and that rational response to uncertainty took certain forms. You read in ordinary press now that the course of the development of securitization was hunger for yield lift. Translate: I am trying to make a profit from selling a dicey security with a fraudulent perspective.

Another very important point is noise. I think we all suffer from a surfeit of information: I have less information, not more information. I have no trust in all these cascades of information. It means you can't have a solid view about anything any longer. You are simply like a leaf blown in the wind, one day there's this news, another day there's that news. Everything that is solid melts away, and you are left a complete wreck intellectually. So, less information, newspapers once a week, television two hours a day, at least news channels (you can have lots of soaps, I don't mind that), but news very, very restricted, and of course that would have the incidental advantage of restricting advertising. Why aren't people listening to the journalists? Because the herd is going the other way. Keynes again said something, bankers are not people who foresee danger and try to avert it. They prefer to be ruined in a conventional way.

Last point: inductive methodology. Well, I'm sure it has uses for all kinds of things, but epistemologically it's very flawed, because it does depend on accepting the inductive principle, that is, on accepting a structure of the universe which is essentially linear. We know the story of the turkey, of course. He used to be fed every day until the hand that fed him wrung his neck. He believed in the inductive principle, that turkey. But that's something we can discuss forever.