

## The Great Recession: Vision Problems of the Experts and Concepts Useful in Avoiding Such Debacles<sup>1</sup>

By Maury Seldin<sup>2</sup>

**"A new scientific truth does not triumph by convincing its opponents and making them see the light, but rather because its opponents eventually die, and new generation grows up that is familiar with it."**<sup>3</sup>

### Some Useful Concepts in Avoiding Debacles

Former Federal Reserve Chairman Alan Greenspan testified before Congress "I did not forecast a significant decline because we never had a significant decline in prices." He was referring to housing prices. A decade earlier, the debacle of Long-Term Capital Management, with leadership from two Nobel Prize winners, occurred when forces exogenous to the sophisticated mathematical models drove prices down to devastating levels. Both cases were outliers in the distribution of expected events seen by application of the inductive reasoning used in the sophisticated econometric models.

It helps to understand how econometric models are constructed, and the concept of outliers. Also, that social science is built upon inductive reasoning, generalizing from the particular experience. A major difficulty is with improbable events, the subject of a book by Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable*. The problem is that social scientists operate "under the false belief that their tools could measure uncertainty." (The prologue discusses three characteristics of Black Swans. One is that they are an outlier. The second is that they have a big impact. The third is that we concoct explanations after the fact that would make it predictable.)

The difference between risk and uncertainty is explained in a book by Edgar R. Peters, *Complexity, Risks, and Financial Market*. Peters explains that uncertainty provides the opportunity to make progress. That opportunity arises because markets are complex systems in that they self organize. The self

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<sup>1</sup> This essay is intended to induce the reader to link to my blog, *Maury Seldin on Strategic Decision Making*, [http://www.hoyt.org/decision\\_making.phtml](http://www.hoyt.org/decision_making.phtml), and see the main essay and heavily annotated bibliography. [Insert links.]

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<sup>3</sup> The statement was made by Max Planck as quoted in *The First Moderns* by William R. Everdell. It was used in an essay published by the Advanced Studies Institute in the spring of 2009, <http://www.hoyt.org/asi/spring99.html>

organization operates without a plan. It is built upon communication among the participants without a plan.

The communication system is built with nodes and links as in the science of networks which “While knowing the rule that govern the behavior of individuals does not necessarily help us to predict the behavior of the mob, we *may* be able to predict the very same mob behavior without knowing very much at all about the unique personalities and characteristics of the individuals that make it up.” So writes Duncan J. Watts, in his book, *Six Degrees: The Science of a Connected Age*. Albert-László Barabasi in his book *Linked: The New Science of Networks* discusses the science of networks in the context of complexity. He notes that we have learned a good deal about the pieces of nature through reductionism, but that “...nature is not a well designed puzzle with only one way to put it back together. In complex systems the components can fit in so many ways that it would take billions of years for us to try them all.” We simply don’t know the laws of self organization.

We do know that in networks some nodes are a stronger influence than other nodes because they have more links of greater influence. Furthermore, we can learn a great deal by going beyond the strong links because they reassure us of what we already think we know, but the weak links can give us new information that may help in better forecasts of outcomes. Thus, the significance of this is in the predictability of the behavior of the system. This predictability is attributable to some underlying principles in the order of the system. Furthermore, since one’s ability to predict outcomes is enhanced in some measure by going outside the circle of close ties; could that mean going beyond one’s own discipline?

Emergence is a concept helpful in viewing the system. Steven Johnson in his book *Emergence: The Connected Lives of Ants, Brains, Cities, and Software* writes that emergence is a self organization, a bottom-up system. As complex adaptive systems, “...agents residing on one scale start producing behavior that lies one scale above them: ants create colonies; urbanites create neighborhoods...The movement from low level rules to higher-level sophistication is what we call emergence.”

The economy in a free society is a complex adaptive system. Michael Shermer writes in his book, *The Mind of the Market: How Biology and Psychology Shape Our Economic Lives*, “Evolution and economics are not just analogous to one another; they are actually two different examples of a larger phenomenon called complex adaptive systems, in which individual elements, parts, organisms, or people interact, process information, and adapt their behavior to changing conditions...they contain self-driving feedback loops...”

The vision problem of the experts is more akin to tunnel vision than myopia. This is an outgrowth of the way that science and society have advanced, especially since the Scientific Revolution and the Age of Reason, also known as the Enlightenment. Knowledge has become more and more compartmentalized as new disciplines sprout out of established disciplines. Furthermore, the organizational structures of universities generally are built upon discipline organization, although some interdisciplinary programs are breaking from the pattern. Additionally, the incentive system at the major universities rewards on the basis of rigorous research published in the learned journals rather than based on the relevance of

research to the issues confronted by society. It takes a wise and patient academic scholar to break from the “strong ties” of the credentialed discipline and venture to the “weak ties” of related disciplines. But, that is how paradigm shifts are most likely to occur, along with greater relevance in the creation of knowledge.

### **The Vision Problem of Experts**

A couple examples of the vision problem of experts were noted in the opening paragraph of this essay. These experts are among the brightest of our nation and well versed in their disciplines. How then can we deal with vision problems when the vast majority of us are not as bright and not as well versed in our disciplines?

There is no easy answer, no silver bullet for this issue of vision, for the *Great Recession* and its trigger, the wealth destruction of the subprime crisis. The Great Recession is the label I used early last year when I saw the character of the emerging recession was different from previous recessions and was likely to be deeper and longer than anything experienced since the Great Depression. My focus was on the subprime crisis and while I saw the freezing up of the credit markets as the salient concern of public policy it was clear to me that the trigger was excessive foreclosures destroying household wealth.

In the fall of 2007 I wrote an essay, “Don’t Panic Yet: A Strategy for Dealing with the Risk of the Emergence of a Housing Bubble Resulting from the Interdependence of Space and Capital Markets.” It was the first of a series of essays linked to the Subprime Crisis Research Program of the Homer Hoyt Institute (HHI). <http://www.hoyt.org/asi/fall2007.pdf> It reflected my vision of the situation and the priority that I saw in a triage to prevent a devastating fallout from the problem.

What emerged from the crisis was so close to my concerns expressed then and as the problem worsened that biased that I am I saw my thinking as prescient. There were some more published essays, but many memos to my colleagues at the Subprime Crisis Research Program continued with the support provided to the Subprime Crisis Research Council (SCRC), a group formed by HHI to deal with the research issues and headed by two co-chairs, each of which served as an Assistant Secretary for Policy Development and Research at HUD, one under a Democratic administration and the other under a Republican administration. The balance in perspectives of the leadership was an important consideration, especially because HHI is not a political partisan, does not engage in lobbying; rather, HHI focuses on facilitating research that improves the quality of real estate related decisions.

That program was launched with a research roundtable, [\[provide link to newsletter\]](#) a long established procedure with HHI. That is described in Chapter 3 of a draft report on the activities of SCRC along with the essays in later chapters. The link is as follows:

[http://www.hoyt.org/decision\\_making\\_document.phtml?page\\_id=2](http://www.hoyt.org/decision_making_document.phtml?page_id=2)

What is the final essay in the series, thus far except for this essay, is “Subprime Crisis Strategic Decision-Making: A Discussion of What Went Wrong and Strategies to Deal With It.” A quote from that essay is “The purpose of this essay is to foster thinking about ways to enhance our understanding of our rapidly changing system. The intent is twofold: (1) to share a perspective that will assist others in modifying

their perspectives and methodologies so as to better forecast outcomes, and (2) to inspire research relevant to facilitating better decision-making, especially by applications of interdisciplinary analyses and the use of a holistic approach.”

After retiring from American University in 1990 and moving to Florida, where I became even more active in community organizations than I had been in Washington, D.C., I really wondered “what were they thinking?” when I participated in meetings resulting in wisdom challenged decisions. The prevailing logic seemed short of what I was accustomed to in Washington where many of the organizations were national in scope. Even the local organizations had higher caliber decision makers; they drew from a larger pool of professionals.

My interdisciplinary perspective went back at least to my senior year at UCLA where in a management course we had collateral reading of *Strategy in Poker, Business and War*. It was buttressed when I took an oil painting class at AU when I saw balance in composition operating on the same principles as balance in the high school physics class that I had taken almost two decades earlier. The crowning touch though, was when in my search for understanding more I read Edward O. Wilson’s book *Consilience: The Unity of Knowledge*. In it he argues for the fundamental unity of all knowledge. The idea is that, “everything in our world is organized in terms of a small number of fundamental natural laws that comprise the principles underlying every branch of learning.” [\[Link to Maury’s notes abridged for web.\]](#)

Since 1990 I have been reading a wide variety of books in order to better understand decision making. Some of those are in the annotated bibliography on the blog site, [\[Link to.\]](#) One of them, an earlier work by Wilson, *On Human Nature*, has a paragraph that would have made my search much less difficult. An excerpt from the paragraph is as follows: “...A schema is a configuration within the brain, either inborn or learned, against which the input of nerve cells is compared. The matching of the real and expected patterns can have one or the other of several effects. The schema can contribute to a person’s mental ‘set,’ the screening out of certain details in favor of others, so that the conscious mind perceives a certain part of the environment more vividly than others and is likely to favor one kind of decision over another. It can fill in details that are missing from the actual sensory input and create a pattern in the mind that is not entirely present in reality. In this way the gestalt of objects – the impression they give of being a square, a face, a tree, or whatever – is aided by the taxonomic powers of the schemata.”

The key was in the continued search for understanding the influences on that perception, including the selection of facts to process and the underlying values. There is abundant nature/nurture literature, and in my alleged retirement I was able to pursue a lot more than had I stayed on with my university responsibilities.

I would like to make it less difficult for academicians to access the relevant literature and not have to go through many books or even read all of a single book in order to pick up on the salient concepts. The blog is a vehicle that will facilitate that process. Previously I have been using essays published as inserts to the Advanced Studies Institute newsletter [\[Link\]](#) and then a monograph, *The Challenge to Our Thought Leaders*. [\[Link\]](#)

The Advanced Studies Institute's Weimer School of Advanced Studies in Real Estate and Land Economics has over one hundred Fellows, five or maybe six are added each year. It has programs for a few academicians at the beginning of their career, but those are for recognition without an ongoing educational program. ASI became very successful in part because it has been managed with reliance on an emergent philosophy; it brings together talented people with common interests and facilitates the communication process. In that sense, the Weimer School is an emergent system for the most part, though it takes some nudging. One of the books on the annotated bibliography, as you may have noticed is *Nudge*.

The major difficulty with the approach is with our major constituents of senior academics in that they are at their prime, with high opportunity costs and a reluctance to pursue investments in development and application of new knowledge that requires a substantial investment with benefits likely to take substantial time to evolve. The opening quote "A new scientific truth does not triumph by convincing its opponents and making them see the light, but rather because its opponents eventually die, and a new generation grows up that is familiar with it" is quite relevant here.

We will draw some of the leadership from the Weimer School Fellows and the Weimer Fellows, the industry counterpart. However, there is room for other senior leadership and especially faculty in the early stages of their career.

The web discussions will draw in experts from other disciplines and will foster expanding participants from economics and finance. Getting out of this recession is going to take longer than generally anticipated, but there is a resilience that should take the economy to a better form and structure than before the debacle.

The character of what emerges will continue to evolve. Academia's structure and contribution is deficient, but its future and that of our society will be influenced by a great many choices of individuals which will in turn be influenced by their communications among themselves and to societal leadership. Universities provide great leverage for academic thought, but the web can leverage the leveragers.

Come be a part of better visions by broadening the understanding of concepts from many disciplines so that you can play a bigger role in lessening the likelihood of the occurrence or at least the severity of the next debacle. The *Great Recession* should be the last of the *great downturns* of depression, recession, or whatever. What you do makes a difference!