

Economic Irrationality and Systems Collapse: When The Irrational Is Considered Rational

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Oh thank you, Wikipedia, for this definition:

“Irrationality is cognition, thinking, talking or acting without inclusion of rationality. It is more specifically described as an action or opinion given through inadequate reasoning, emotional distress, or cognitive deficiency. The term is used, usually pejoratively, to describe thinking and actions that are, or appear to be, less useful or more illogical than other more rational alternatives.”

And what about this one? Market Psychology? This term is defined in the Investopedia this way:

“The overall sentiment or feeling that the market is experiencing at any particular time. Greed, fear, expectations and circumstances are all factors that contribute to the group’s overall investing mentality of sentiment.” Q: What do we have when we put the two together? A: The current madness and market mayhem, S&P’s downgrade is being blamed for the market panic even though all the business media expected a downgrade and initially minimized its potential impact. The ratings agency blamed the government’s failure to deal with the debt including the stalemate in Congress, The Republicans, predictably blamed Obama and the Democrats went after the Tea Party as the culprits behind the market plunge. But then, investors who at first denied that a downgrade would be significant overreacted to it by pumping more money into government treasuries adding to government debt. The Comedy Channel’s Jon Stewart’s sensible reaction: “are you f*cking kidding me?”

Does this make any sense? We are taught to think of businessmen and their minions as absolute worshippers of objective truth as they allegedly practice “due diligence” to confirm underlying facts and insure that their decisions are based on research and thoughtful decisions. That’s what we are taught—but is that what they do? In fact, the “smartest guys in the room” as the Enronians were called proved to be the dumbest, buying into a warped worldview, and then, believing their own hype leading to decisions that brought the house down. And that’s what happens again and again, over and over, as panic seizes The Street followed by a herd of decision makers making bad decisions.’

Paul Farrell has written about this phenomenon on Marketwatch: He speaks of “all the too-greedy-to-fail fatheads running Wall Street? And, unfortunately, Main Street America’s 95 million irrational and self-sabotaging investors Yes, all of us! We’re Americans. Don’t confuse us with the facts, with reality. We’re the greatest in history, a legend in our own minds. And a rapidly mutating virus is spreading this lethal pandemic far beyond the shores

of Lake Wobegon. Yes, folks, the “Lake Wobegon Effect” is hard-wired in America’s brain, an illusion of superiority, a smug arrogance where each knows we are the best, the chosen ones.

Warning: The Lake Wobegon Effect is the single best summary of today’s stock market psychology, high frequency trading, behavioral economics theories and the new science of irrationality ... and it’s sucking the life out of America’s soul. Here, listen to more of these arrogant musings surfacing everywhere from deep in our collective brains.” So forget all of our devices, our forever present blackberries, iPhones, iPads and Bloomberg terminals with their enhanced graphics and multiple sources. Alas, there’s no panic button that gives you a quick dose of financial history, perspective or context. Our hi-tech world often leads to repeating low-tech mistakes in a speeded up environment driven by all those dazzling terminals. TV screens blazing and the pundits buzzing.

Farrell reminds us of a psychological game called “The Invisible Gorilla.”

He calls it “one of the most famous psychological demos ever. Subjects are shown a video, about a minute long, of two teams, one in white shirts, the other in black shirts, moving around and passing basketballs to one another. They are asked to count the number of aerial and bounce passes made by the team wearing white, a seemingly simple task.”

Stop. Test yourself before you read on. What does “The Invisible Gorilla” study tell you about the brains of folks gambling in Wall Street’s casinos? Where billions of shares, trillions of dollars, stocks, bonds, derivatives trade daily? What’s “invisible” to you?” Institutionalized Irrationality—perhaps even insanity—helped cause the financial crisis as the federal inquiry commission pointed out quoting an appraiser who watched the real estate industry underwrite loans with no collateral over and over again: “I see a lot of irrationality,” he added. He said he was unnerved because people were saying, “It’s different this time”—a rationale commonly heard before previous collapses.”

Many writers of distinction could see the irrational trumping the rational coming, as I wrote in my book *Plunder* that came out a month before the 2008 crash.

I quoted Mark Twain, America’s greatest man of letters, He once asked: “Why shouldn’t truth be stranger than fiction? Fiction, after all, has to make sense.” (His novella, *The Man Who Corrupted Hadleyburg*, was written while he was in Europe on the run from creditors.)

Fast forward a century or more as business and political leaders alike try to make sense of a relatively sudden and unexpected market meltdown in the summer of 2007 then again in 2008 and then again this past week.

Ultimately perhaps Twain’s insight will lead to great novels that will capture the corruption of the underlying culture that allowed so many financial manipulations and so much greed, avarice, and irrationality in this era in the way that great writers of economic upheaval in America like Upton Sinclair, John Dos Passos, or Jack London castigated theirs.

It seems to have always been true, as a friend who watched his multi-ethnic city of Sarajevo implode into a bloody genocidal war in Bosnia years ago confided to me, “only fiction has to be plausible. Real life has no such constraint.”

As a journalist with perhaps less fictional imagination than I need, I can only try to probe

deeply into some of the forces that took our economy down in such an unexpected way at a time when our national leaders were looking elsewhere and thought they saw the only threat to our country coming from terrorists hiding in caves in far away lands.

They - and I include among them, representatives of both parties, and most of our mass media - ignored cries for help from victims of predatory lenders dating back into the 1990s, and, then, for years warnings from David Walker, the Comptroller of our Currency and head of the Government Accounting Office (GAO) that our growing debt burden could lead to a sudden collapse threatening our national security. He had been labeled "Dr. Gloom" for his sobering prognostications. In February, 2008, he stepped down from government, frustrated by his inability to promote changes.

A closer look, usually in times of crisis, offers a window into another kind of financial world, a world of panic and fear, where irrationality is the order of the day, an irrationality that goes by the name of "Market Psychology."

Forget the bulls or the bears...this is a world of sharks deeply in need of shrinks.

When things go well, the wizards of Wall Street are anointed by the media as geniuses. When they don't, you get Time Magazine's condescending putdown of "Wall Street's mad scientists blowing up the lab again."

This kind of humor seems out-of-place when we are talking about what many fear has led to the collapse or at least a severe wounding of the global economy with millions of jobless and homeless victims who believed in the system until it failed them. And yet, as we saw in the great manufactured budget stalemate in Washington, members of Congress were and still are prepared to trigger a collapse in the name of a naïve but rigid ideology. Some of us argue with them thinking our facts can refute theirs but at bottom, fanaticism is not neutralized by rational argument. You need countervailing power and a willingness to fight for another vision.

News Dissector Danny Schechter made the film Plunder The Crime of Our Time (plunderthecrimeofourtime.com) about the financial crisis as a crime story. Comments to dissector@mediachannel.org

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