The Daily Dish

Financial Stability and AI

DOUGLAS HOLTZ-EAKIN | OCTOBER 16, 2023

Not content with a record of hyperactive overreach and unnecessarily burdensome rulemakings, Securities and Exchange Commission (SEC) Chair Gary Gensler is now unburdening himself to the *Financial Times* about regulating artificial intelligence (AI). Specifically, "without swift intervention it was 'nearly unavoidable' that AI would trigger a financial crisis within a decade."

Wow! How will this happen? "I do think we will in the future have a financial crisis…[and] in the after action reports people will say 'Aha! There was either one data aggregator or one model…we've relied on. Maybe it's in the mortgage market. Maybe it's in some sector of the equity market,'" Gensler said.

That seems a bit much. At this juncture there are, roughly speaking, "narrow" AI and "general" AI applications. Narrow AI are models and mechanisms built upon experience and real-world data to achieve very specific objectives such as translating languages, predicting the weather, and reading medical scans. Narrow AI doesn't seem to raise any new regulatory issues. If it were desirable to limit or preclude the objective, it would already be regulated; how it gets done doesn't matter so much. In this regard, it is useful to note that the Financial Industry Regulatory Authority is already working on regulations for the relatively narrow world of algorithmic trading.

General AI are decision-making systems able to cope with a generalized task such as investing in the same way a human does. This seems to be what most people associate with the term AI. As it is moving the boundaries of activities, it may merit some new regulatory initiatives, but most likely not today. And most likely not by the SEC, which Congress has not given the authority to regulate general AI (not that a lack of authority has stopped it in the past).

Of course, that will not stop everyone. An expert or pundit or SEC Chair will generate an apocalyptic prediction about how general AI will evolve and there will be calls to regulate it to a standstill. This would be a mistake because those predictions are likely way off the mark. A retrospective review of technology forecasts found that predictions beyond a decade were hardly better than a coin flip, and a similar analysis focused on AI predictions warned against “the general overconfidence of experts.”

Besides, there is nothing in the historical record that gives me any confidence that the SEC is up to such a task. The financial crisis was built on a huge one-sided bet on housing. Everyone was using the “same model” and the SEC let it deliver the failure of Bear Stearns, Lehman Brothers, and a cascade of others leading to the financial crisis and Great Recession.

There are two great regulatory turf wars underway in Washington: crypto and AI. These comments seem more motivated by a land grab than reality.