Review of Nassim Nicholas Taleb, The Black Swan:

The Impact of the Highly Improbable (2007)

For Taleb, a Black Swan (a) lies outside the realm of regular expectations, (b) carries an extreme impact, and (c) human nature makes us concoct explanations for its occurrence after the fact, making it explainable and predictable. Taleb gives many examples of events satisfying (a) and (b), and the "explainable" part of (c). However, he fails to show that the "predictable" part of (c) is common or ubiquitous. Of course, there are always individuals who have crazy ideas and try to sell them by claiming that they explain and predict high-impact unforeseen events.

For instance, in the case of the US financial crisis of 2007, a major focus of Taleb's, I have read several books that claim to explain and to have predicted the crisis, all coming from what I consider to be unfounded, and politically motivated, models of financial market competition and its regulation by the Securities and Exchange commission. However, this is surely not part of "human nature" because if you read the economics journals and many other books, the claims of "explanation" are tentative and muted, and there are no claims of "predictability." My own view is that the bursting of the housing bubble was completely predictable, its impact on the series of banking crises is explainable in hindsight, and if we had the information in 2006 that we have now (especially about auditing irregularities and the marketing practices surrounding the selling of subprime mortgages) we might have predicted the possibility of bank failures.

Taleb supports the validity of the "predictable' part of (c) by providing, at best, anecdotes. But the plural of anecdote, so the saying goes, is not data. I, for one, do not believe that there is a failing of human nature that propels to see predictability in hindsight where predictability prior to the event was absent. "It is easy to see," says Taleb, "that life is the cumulative effect of a handful of significant shocks....The inability to predict outliers implies the inability to predict the course of history, given the share of these events in the dynamics of events." This is of course quite true, and I know of no one who has ever doubted this. However, Taleb goes on to say "But we act as though we are able to predict historical events, or, even worse, as if we are able to change the course of history." In fact, very few of the serious scholars I have known or known about has claimed the ability to predict the course of history. Moreover, we "act as though we are able to change the course of history" because we in fact can, through both individual and collective action.

Consider for example Taleb's treatment of the terrorist bombing of the World Trade Center in 2002. "What did people learn from the 9/11 episode? Did they learn that some events, owing to their dynamics, stand largely outside the realm of the predictable? No. Did they learn the built-in defect of conventional wisdom? No. What did they figure out? They learned precise rules for avoiding Islamic prototerrorists and tall buildings." This is, of course, exactly wrong. The United States and other threatened countries reacted to the 9/11 episode by overthrowing the Taliban in Afghanistan, which had supported the training operations of Al Qaida. The Saudi's attacked and destroyed Al Qaida at home, and the US armed services began long-term planning for counterinsurgency operations around the world. The current regime in the US has mounted a quite successful attack on the international Islamist terrorism network. No one sane person claims to have "predicted" 9/11, and most involved researchers do not think we have even "explained" the rise of Islamist terrorism. But there has been strong reaction to parts (a) and (b) of the Black Swan trilogy, contrary to Taleb's argument.

Another of Taleb's claims is that social scientists have an incorrect and falsely optimistic model of risk. Almost all social scientists, he claims "for over a century, have operated under the false belief that their tools could measure uncertainty. For the applications of the sciences of uncertainty to real-world problems has had ridiculous effects; I have been privileged to see it in finance and economics....This problem is endemic in social matters." I believe that standard financial economics suffers precisely from such an incorrect model, but I do not know of any other important examples in the social sciences. Most important, this is not a failure of economic theory in general, but of a particular branch of economic theory---indeed, one that not even taught in economics departments (although it clearly should be, and will in coming years).

Taleb's distorted sense of social science leads him to make absolute absurd claims concerning the value of analytical modeling. For example, I have in my house ...a wall full of books on statistics and the history of statistics, books I never had the fortitude to burn or throw away; though I find them largely useless outside of their academic applications ...I cannot use them in class because I promised myself never to teach trash, even if dying of starvation." This is a completely incorrect assessment of the role of statistics in the social sciences. Statistical reasoning is quite central to all of social theory and the evaluation of evidence for and against particular social science models, including the evaluation of pharmaceuticals, modeling the demographics of disease, testing products for beneficial and harmful effects, and a host of others. Taleb's generalization from the weakness of standard financial economics to the whole of mathematical discipline is quite unwarranted. However, he does not stop there. All of academia is tarred with his brush of hypocrisy and irrelevance. "...almost all academic papers," he claims, "are made to bore, impress, provide credibility, intimidate even, be presented at meetings, but not to be read except by suckers (or detractors) or, even worse, graduate students." Note that he claims not simply that academic papers "bore," but that is what they are made for! And he claims that academic papers "are not to be read except by suckers"! Taleb's writing is filled with unsubstantiated and improbable statements of this type.

To his credit, Taleb offers "Ten Principles for a Black Swan Robust Society." Some of them are quite reasonable, and are indeed part of the solution to preventing financial crises in the future, although their relevance to other improbable event scenarios is questionable. Principle 2 says that there should be no "socialization of losses" and "privatization of gains", Principle 4 says people in sensitive positions should have the proper incentives to carry out the duties, Principle 6 says that ordinary citizens should have simple and useful financial instruments at their disposal, and ". Complex financial products need to be banned because nobody understands them, and few are rational enough to know it. We need to protect citizens from themselves, from bankers selling them "hedging" products, and from gullible regulators who listen to economic theorists." Principle 7 says that Ponzi schemes should be outlawed and Principle 8 says that we must legislate against the tendency of financial institutions becomes overleveraged.

Most of Taleb's suggestions are quite reasonable, but they do not depend on the Black Swan syndrome. Most economists would certainly subscribe to Taleb's principles, although a couple are quite difficult to implement, such as Principle 1, which says that. "Nothing should ever become too big to fail."

I did not like this book at all. Taleb is pompous and arrogant, making wild accusations that cannot possibly be supported by the fact. Moreover, there is nothing new here, although if you have not thought before about the vagaries of history, you might find many eye-opening episodes described here.