

. . . And Black Swans

By David Ignatius

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If I could set the American political agenda for a day, I would ask George Bush and his Democratic presidential challengers to explain how they think about risk. That's not the normal "Meet the Press" fodder, but bear with me -- because the issue goes to some of the central questions that ought to be debated in this campaign, starting with our difficulties in Iraq.

Iraq teaches us that even when we think we know what we are doing -- even when we think we have the relevant facts -- we don't. That's the overwhelming message from David Kay's inability to find the weapons of mass destruction that were almost universally expected -- and from the turbulent state of postwar Iraq.

As it happens, the Pentagon sponsored a two-day conference in November on risk. I've been sampling some of the papers presented at that conference, and they make provocative reading. The Economist also had a superb survey of risk in its Jan. 24 issue. So there's plenty of material for our imaginary presidential debate.

Managing risk is arguably the most important challenge for any political or business leader in the 21st century, and yet it's rarely discussed. Perhaps that's because our heroic models of leadership have been about ignoring or minimizing risk -- as in, "Damn the torpedoes, full speed ahead."

From John F. Kennedy to George W. Bush, American politicians have talked about "bearing any burden, paying any price," in fighting for the nation's values. The implication has been that if you're sailing the ship of state in the "right" direction -- against terrorism, say, or some other variant of evil -- then you won't wind up on the rocks. We accept such bravura recklessness from political leaders, but any CEO who advanced similar logic would be fired.

A wise contrarian analysis of risk comes from a Lebanese-born mathematician and financial trader named Nassim Nicholas Taleb, who wrote a best-selling book called "Fooled by Randomness." He presented a remarkable paper to the Pentagon conference called "The Black Swan: Why Don't We Learn That We Don't Learn?"

Taleb's basic point is that the events that drive history are outliers -- "black swans" that don't meet our expectations because we've seen only white ones. We tend to assume risks are distributed with the same type of randomness as height, weight or blood pressure. But in fact, the events that really matter don't follow those predictable rules at all. They embody what Taleb calls the "power law" of all or nothing.

"Our ability to predict large-scale deviations that change history has been close to zero," he notes. We tend to get our guidance about what to do in the future from our experience of the past -- which is actually irrelevant. Taleb likens it to a driver who looks only in the rearview mirror, and inevitably runs into walls.

Another problem with risk, beyond its unpredictability, is that it tends to skew. If one bad event happens, that may increase the likelihood of another -- because of network effects we don't understand.

That's what famously happened with the 1998 meltdown of Long-Term Capital Management. This investment fund hired some of the smartest people in the world (two of them had won Nobel Prizes) to make mathematical models to quantify the likelihood of different economic events.

But the geniuses never imagined that, in layman's terms, everything could go wrong at once. And that's just what happened in the bond market after the Russian default of September 1998. The fund went belly up, losing billions of dollars and causing havoc on Wall Street.

Iraq is like Long-Term Capital Management, in that smart people sailed into a potential disaster thinking they knew what they were doing. The president, advised by the intelligence community, thought he understood the threat Saddam Hussein's regime posed. And he thought he understood the risks for America in rebuilding postwar Iraq. The benefits of action seemed to outweigh the risks of inaction. But smart people got it wrong, at both ends of the scale.

So in the shadow of Iraq and the WMD debate, I would ask the presidential candidates: How do you think about risks? What is prudent stewardship for the nation in a time of so much volatility? How do you make decisions in a world where you never know what you don't know?

I hope this year we will pay more attention to leaders who admit they aren't sure where the dangers lie -- and for that reason want to be careful. And we should be wary of anyone who talks in certitudes about the risks facing the nation -- oblivious to the possibility that a black swan could suddenly descend.

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