



Published on *The Big Money* (<http://tbn.thebigmoney.com>)

[Home](#) > Mr. Taleb Goes to Washington

Mr. Taleb Goes to Washington

By *marion.maneker*

Created 03/26/2009 - 11:18am

Nassim Taleb is an unlikely choice to play the Jimmy Stewart role in a 21st-century remake of the Depression-era classic *Mr. Smith Goes to Washington* [1]. But the tale of a naive do-gooder who tries to remind a corrupt political class of its obligations was re-enacted this week when Taleb attended the *Wall Street Journal's* Future of Finance conference in Washington, D.C.

A French- and Arabic-speaking former options trader with a taste for obscure Greek philosophers and the ambition to be seen as a literary figure, Taleb has grown famous for his book *The Black Swan* [2], which has sold 1.5 million copies around the world in 12 countries, with 19 more still to come. Although the book does not predict the current economic crisis per se, it rather loudly, elaborately, and—with a comically baroque form of storytelling—uniquely warns of the potential for a great catastrophe in the world economic system.

Now that the catastrophe is here, Taleb's [anger at the economic establishment](#) [3] that drove us over this cliff—and populates the *Journal's* conference—makes him a representative figure of ordinary people. Like most Americans, Taleb is seething with rage about the financial establishment's role in bringing the about credit crash. "Nobody saw the crisis coming," he says. "Bernanke, all these guys, I want them out. They proved incompetent, they crashed the plane."

Unlike us, the innumerately dumbstruck, Taleb is comfortable with the theory and practice that undergirds the whole system of options, derivatives, and risk management that has spun so recklessly out of control. That talent mixed with his righteous anger makes him a rare bird: an Everyman who can do the equations.

In private, Taleb takes a specific kind of glee in the wreckage of modern finance. He has been arguing for years that the "adult supervision" in the financial system—the worthy academics, regulators, and heads of the large banking institutions—has been deluding itself with talk of a great moderation. To Taleb, the supposed stability brought about by complex financial derivatives, global banking connections, and accelerated flows of capital was a mirage masking the accumulation of massive amounts of hidden risk.

For Taleb, along with that other Grand Guignol figure of the economic collapse, Nouriel Roubini, being right has meant sudden access to an elite that used to ignore him. It's hard to think of a more establishment figure than Alan Murray, the executive editor for the *Wall Street Journal* online. Murray is also the man who interviews the CEOs, politicians, and other worthies onstage when the *Journal* holds a conference. That makes him the public face of the *Journal* among the corporate elite.

In normal times, the conferencariat are an arrogant bunch. This is something Murray knows well from his

travels on the conference circuit, which begins each year with the World Economic Forum in Davos. "Davos is usually filled with people who have all the answers," Murray says. "What was so striking about Davos this year was all these people, for once, didn't have all the answers. No one could tell you with certainty what was happening or what needed to be done."

No one but Nassim Taleb. Before Davos, Murray read *The Black Swan*. At the conference, the newspaperman and the trader had many conversations over the course of four days. Murray came to the conclusion that Taleb was the iconic figure of Davos in 2009. "In my mind, he had the perfect message for the moment."

So Murray invited Taleb to the Future of Finance Conference, where 100 grandees of the financial world, ranging from Steve Schwarzman and George Soros to Meredith Whitney, Peter Fisher, and Nobel laureate Myron Scholes, got together to outline some principles for rebuilding the financial system. The conference opened with Murray [interviewing Treasury Secretary Tim Geithner](#) [4] fresh from his 497-point victory lap after the announcement of his plan to deal with the toxic mortgage-backed assets. It closed with a field trip to the White House and an audience with Lawrence Summers.

Nassim Taleb turned down the chance to kiss Summers' ring. He left after dinner the first night. While the 130-person conference debated the government's new regulations that George Soros described as [merely "tinkering"](#) [5] with the system, Taleb has a clear-eyed plan.

First, he says, we have to unmask the charlatans of risk like Myron Scholes. To Taleb, Scholes is the Great Oz in this Emerald City because his work on options and derivatives allowed the whole of the financial system to adopt poorly understood products—like the ones that brought AIG down—that hide risk. To Taleb, Scholes' academic work, which enabled the widespread use of complex derivatives, was like "giving children dynamite."

"This guy should be in a retirement home doing Sudoku," Taleb says. "His funds have [blown up twice](#) [6]. He shouldn't be allowed in Washington to lecture anyone on risk."

With complex derivatives unmasked and, in Taleb's vision of the future, outlawed, the next step is to create a more robust version of capitalism. Taleb calls it Capitalism 2.0. Robustness begins with a dismantling of debt. Leverage was the gas that inflated the financial system until it was too big, too fragile, and too volatile.

Over the past 20 years, the financial system has grown ever more complex. Building on a greater computing capacity and communication speed—"Bank runs now take place at the speed of BlackBerry"—Taleb recognizes that the financial system now possesses an efficiency that creates volatility. That cannot and will not go away.

We cannot have both debt leverage and a hyper-efficient system—the volatility is just too great. What Taleb explains—which no one else does—is that efficiency is already a form of leverage. A highly efficient system removes slack and magnifies small changes. Think of the efficient system as a high-performance aircraft. Each minute of steering input creates a rapid and violent shift of course, speed, or altitude. The system itself is souped up even before you add the debt. Once you do, the pilot is equally jacked up and twitchy, creating an explosive combination. Now imagine that fighter jet trying to fly in a 1,000-plane formation, and you get an idea of the world financial system in the 21st century.

We can't erase the technology that created the planes, so we'll have to make sure we fly sober, maybe even with an onboard computer that dampens the controls. That means getting rid of the debt. It's that simple.

A deleveraged financial system is a stable one, especially if we increase the redundancy within the system.

That's an idea Taleb has taken from biology. But in finance, redundancy means two things: not having players in the game who are "too big to fail" and not allowing anyone—from the individual to the institution—to play with too much money. Redundancy means have cash on the side, not risking it all, and not becoming dependent upon financial assets for your economic well-being.

Did the conference see things Taleb's way? Not really. Back at the office, many of the financial leaders present had teams of analysts working on the government's newly proposed plan for toxic assets. Instead of deleveraging, here was a plan to use more leverage (provided by the government) to solve the excesses created by leverage.

Although Taleb was impressed with Geithner, his anger has hardly dissipated. "The center of the problem is that they don't know the center of the problem," he says. "They have not yet entertained the idea that what we may be witnessing is a total failure of a way of doing business."

It would be great to end this story the way Frank Capra ends *Mr. Smith Goes to Washington*: with a valiant filibuster that brings the country to its senses. But so far Washington and Wall Street are treating Taleb more like another Jimmy Stewart character, the one in [Harvey](#) [7], whose best friend is an invisible 6-foot rabbit.

Source URL: <http://tbn.thebigmoney.com/articles/judgments/2009/03/26/mr-taleb-goes-washington>

Links:

[1] http://www.amazon.com/gp/product/B001GLX6UI?ie=UTF8&tag=thebicom04-20&link_code=as3&camp=211189&creative=373489&creativeASIN=B001GLX6UI

[2] http://www.amazon.com/gp/product/1400063515?ie=UTF8&tag=thebicom04-20&link_code=as3&camp=211189&creative=373489&creativeASIN=1400063515

[3] <http://www.youtube.com/watch?v=ABXPICWjFIo&feature=related>

[4] <http://online.wsj.com/video/the-future-of-finance-conference-opens/9329AA39-082B-4E65-BA89-B5A0F1954771.html>

[5] <http://blogs.wsj.com/deals/2009/03/24/george-soros-all-this-new-regulation-is-just-tinkering/>

[6] <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aN26ZWOziGwk>

[7] http://www.amazon.com/gp/product/B0000549B0?ie=UTF8&tag=thebicom04-20&link_code=as3&camp=211189&creative=373489&creativeASIN=B0000549B0