



Stick Your Neck Out

Publish Date:

November 2018

In this review of [“Skin in the Game; Hidden Asymmetries in Daily Life”](#), Scott Hargreaves argues that Nassim Nicholas Taleb’s writings on the benefits of a stake in risks—‘skin in the game’—are helpful at policy and personal levels alike.

Nassim Nicholas Taleb is one of the most interesting thinkers to have emerged in the 21st century, both for what he says, and how he says it. He burst on the scene with [The Black Swan: The Impact of the Highly Improbable](#) in 2007. His expertise is in risk, options trading, and statistics, so he could be a bookish professor, but he deliberately limits his professorial duties to a quarter of his time so he can manage his investments and also write lines like this:

“What we saw worldwide from 2014 to 2018, from India to the UK to the US, was a rebellion against the inner circle of no-skin-in-the- game policymaking ‘clerks’ and journalist-insiders, that class of paternalistic semi-intellectual experts with some Ivy League, Oxford-Cambridge or similar label driven education who are telling the rest of us 1) what to do, 2) what to eat, 3) how to speak, 4) how to think, and ...5) whom to vote for.”

Such quotes do have the tone of a populist's crowd-pleasing rhetoric, and so naturally *The Guardian* dismisses Taleb's style as 'dumbeddown'; but beneath his rhetoric is an entire body of theory and practice he has been sharing with the world for nearly two decades. He coins powerful rhetorical phrases and polishes short and insightful epigrams to sum up argument, consciously following the classical style, revived in modern times most notably by the German philosopher Friedrich Nietzsche. Contra *The Guardian*, the capacity to distil complex subject into accessible phrases and epigrams, without losing meaning, is indicative of a first-rate mind. Taleb has a very low opinion of journalists, and snide reviews of that kind are one of the reasons.

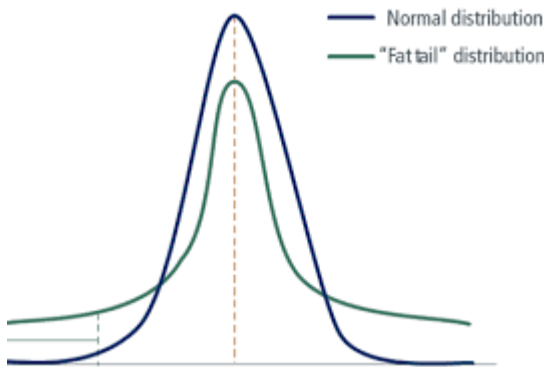
The concept of 'skin in the game' was introduced to the world prior to this book's publication; through a body of works Taleb collectively calls *Incerto*, which is Latin for uncertainty. He publishes refereed journal articles, tests ideas out on Medium.com/incerto, and before this has released four other books. Most well known is *The Black Swan: The Impact of the Highly Improbable*, released in 2007 just in time for the Global Financial Crisis (GFC), which it was seen to have more or less predicted (it was a best seller, and the UK's *Sunday Times* described it as one of the 12 most influential books since WWII).

Incerto has recurring ideas and themes and is ideally grasped in a somewhat circular process of reading, as new ideas are developed in front of you and old ones invited back like old friends. Happily, as the ideas are solidifying and Taleb's work of intellectual construction approaches completion, the individual books have become more accessible (with more and more of the statistical/mathematical explanations shunted to an Appendix). When I read [*Antifragile: Things That Gain From Disorder*](#) (2012), I told a colleague I thought it was brilliant but couldn't read more than a page a night before my brain started to hurt. With this book, I found I could read a chapter at a time, resulting in only a mild dull throbbing headache.

Taleb insists reading one good book twice is of more value than reading two goods books once, and it's certainly necessary in his case (but worth the effort).

BUT THEN IN 1697 THE DUTCH EXPLORER WILLEM DE VLAMINGH DISCOVERED BLACK SWANS IN AUSTRALIA

Black Swan is concerned with 'fat-tailed' risk distributions, where improbable ('black swan') events out on the edges in the tails of the probability distribution can ruin us. As far back as Aristotle it was so blindingly obvious that all swans were white, a reference to a black swan was made to describe something that is by definition impossible. But then in 1697 the Dutch explorer Willem de Vlamingh discovered black swans in Australia. The easy thing to do would be to say 'but no one could have predicted that', but Taleb believes the original display of absolute certainty is a perfect example of a false premise with bad logic, displaying 'epistemic arrogance'. It should be a lesson on the limits of everyday experience and indeed scientific knowledge (based on data from the past).



The chances of getting it wrong are increased when the decisionmaker does not have skin in the game: that is, does not suffer any harm in the event that the black swan event occurs with ruinous consequences. His prime example is what he calls the *Bob Rubin Trade*. Robert Rubin was an investment banker who became Secretary of the Treasury in the US under President Bill Clinton, and then afterwards became first Director and then Chairman of Citibank. In that time he received more than US\$100 million in salaries and bonuses (for performance), right up until the time the financial meltdown made the bank insolvent and it was bailed out by the American taxpayer.

Rubin enjoyed the upside of the boom but suffered none of the downside, and walked away from the mess blaming uncertainty ('but no one could have predicted that...'). Taleb's counter-argument is that in fact financial markets display precisely the fat-tailed risk distributions that he studies, and the absence of skin in the game by management exacerbates the impact of adverse events. It encourages greater financial leverage (more reliance on debt than equity), short-term gain hunting, and risk-seeking behaviour.

THE ABSENCE OF SKIN IN THE GAME BY MANAGEMENT EXACERBATES THE IMPACT OF ADVERSE EVENTS

For Taleb behaviour like Rubin's is not just an intellectual failure, it is a moral failure. A former trader (of financial options) himself, he believes in virtue ethics, in which traders must have some skin in the game for the transaction so there isn't the incentive to rip people off. He was born and educated in Beirut, Lebanon, among the Greek-Orthodox community, and draws inspiration from the common body of laws and practices developed by traders around the Mediterranean from classical times through to modernity. For most traders, the skin in the game is reputation: hiding a product defect or lying about risks might make you some money in the short term, but once found out you no longer have anyone to trade with. The incentives for right conduct were brought into the English common law rules governing commerce by Lord Mansfield in the 18th century, establishing torts, or causes of action in the courts, for the harm suffered as a result of a trade which doesn't meet the ethical tests.

The neatest example of skin in the game is the pilot of an aeroplane—we all go down together, so the pilot bears the same risk as you. And the risk of an individual flight is reduced because the bad pilot (in the tail of the risk distribution) will most likely already have removed himself from the gene

pool. The system is safer because unsafe actors remove themselves from it, when they have skin in the game. In business, this is why it's so important bad business are left to fail.

To avoid the intellectual traps of misunderstanding the nature of risk, Taleb says we must have our feet on the ground. We take risks (but not ones that could wipe us out), we make mistakes, we learn. We examine the wisdom of the ancients, including our grandmothers. They got it from their grandmothers who got it from their grandmothers, so there must be something in it. A potential grandmother who wasn't following the wisdom didn't last long enough to pass on bad ideas. Survival is the key to understanding risk, particularly in complex systems such as human societies.

The increasing prevalence of the moral failure that comes from having no skin in the game comes with the growing complexity and incredible growth in the size of Government seen in modern times. The bureaucrats of big Government, academics in bloated universities and the managerial class of business all have their own pathologies, and stand in poor contrast to entrepreneurs and/or leaders of former days who led their people into battle, and shared the risks with their troops.

The official culture places a high virtue on being disinterested, impartial, with nothing at stake. To Taleb this is precisely the situation most likely to lead to epistemic arrogance and needless risk-taking. The elites respond to the public's doubt with ever-greater piles of statistics, but this is nothing more than what Taleb calls scientism, 'using mathematics where it is not needed', with 'a naive interpretation of science as complication rather than science as a process and a sceptical enterprise.'

And in modern society the leaders of these institutions got there through a selection process that involves passing tests. They go to prestigious institutions of higher learning—thus avoiding real work and the learning that comes from taking everyday risks in employment and business—and are fast-tracked if they show the aptitude to do well on tests. *The Intellectual Yet Idiot* (IYI) is 'a product of modernity, hence has been proliferating since at least the mid-20th century.' The IYI:

“...pathologises others for doing things he doesn't understand without realising it is his understanding that may be limited ... When plebeians do something that makes sense to themselves, but not to him, the IYI uses the term 'uneducated'. What we generally call participation in the process he calls by two distinct designations: 'democracy' when it fits the IYI, and 'populism' when plebeians dare to vote in a way that contradicts IYI preferences.”

In the interrelationship between power and the IYI, there is the massive opportunity for the rentseeking behaviour that we do in fact observe, with businesses and other organisations seeking protective regulations or rights to derive income without adding anything to economic activity.

Along the way he skewers Thomas Piketty's *Capital in the Twenty-First Century*, saying the statistics are wrong and the methodology flawed, relying as it does on static rather than dynamic measures of inequality.

“We’ve made a big deal out of Piketty here because the widespread enthusiasm for his book was representative of the behavior of that class of people who love to theorise and engage in false solidarity with the oppressed, while consolidating their privileges.”

Taleb’s philosophical underpinnings are a revolutionary challenge to the Kantian ethical framework taught to and relied upon by IYI and do-gooders of every stripe. In a very short chapter, Taleb examines and disposes of Kant’s categorical imperative, summarised as:

“Behave as if your action can be generalised to the behaviour of everyone in all places, under all conditions.”

Non-philosophers like me who have been invited to lectures on business ethics will have been presented with Kantian ethics alongside utilitarianism, with the lecturer setting up a contrast between the universal rules of Kant with Jeremy Bentham’s greatest good for the greatest number. Here, Taleb explicitly disposes of Kant and also implicitly disposes of Bentham. Kantian universalism (and abstractions generally) don’t work because

“...we are local and practical animals, sensitive to scale. The small is not the large ... We should focus on our immediate environment; we need simple practical rules. Even worse: the general and the abstract tend to attract self-righteous psychopaths ... the deep message of this book (Taleb’s) is the danger of universalism taken two or three steps too far—conflating the micro and the macro.”

TALEB IS A STUDENT OF CLASSICAL WISDOM, HANDED DOWN FROM SOCIETIES WHICH SURVIVED

Taleb’s argument is both ontological—about the nature of things—and political, as he favours localism and federalism. He quotes the dictum:

“I am, at the Fed level, libertarian; At the state level, Republican; At the local level, Democrat; And at the family and friends level, a socialist.”

The implicit rebuke to Bentham is in the idea that one could calculate utility prospectively and confidently make changes to institutions so they better fit the model of an improved society. As my colleague Matthew Lesh pointed out in a chapter for [*Australia’s Red Tape Crisis: The Causes and Costs of Over-Regulation*](#) (Connor Court Publishing, 2018), the Benthamite utilitarianism which came to Australia with the early settlers lent itself to utopian plans for social improvement, and thus encourages big government and a burgeoning set of rules governing commerce and private behaviour. Taleb rebukes Bentham’s heirs in the ‘Nudging’ school pioneered by Richard Thaler and Cass Sunstein, because:

- interventions that seem like good ideas don’t necessarily scale
- the interventions will have effects you can’t predict (because society is a complex system)
- in any event, you guys are IYIs who don’t even understand the statistics you claim to be

relying on

Virtue ethics is, instead, focussed on the choices in front of us, and suspicious of grand promises. Taleb is a student of classical wisdom, handed down from societies which survived. He rejects abstract definitions of rationality whether from Kant or from behavioural economists, rather, 'what is rational is that which allows for survival'. At the societal level, the fact that wisdom has been handed down means it probably has inherent value, because the society that produced it flourished for a very long time.

This also leads to a fascinating take on religion vs atheism, because the religions of the world all represent that wisdom to some extent. He draws examples from Classical (pagan), Chinese, Judaic, Christian and Islamic civilisations, pointing out only that the role of religion differs between them all; whether it be from religion as law (Sharia) to religion as ritual (paganism). He has positive things to say about most religions, and defends the conception of law and religion in the Shia branch of Islam. He believes it was essential in Christianity for Jesus to be both human and divine, as he needed to be human to have skin in the game. That is what enabled his sacrifice to be real, and not just some variant of the trickery the Olympian gods used to play on the Homeric Greeks. His harshest words for the militant atheists, who focus too much on beliefs and not deeds, when only deeds matter:

“... I know of nobody who is atheist in both actions and words, completely devoid of rituals, respect for the dead, and superstitions (say a belief in economics, or in the miraculous powers of the mighty state and its institutions)”

This review has covered perhaps only 20 per cent of the often brilliant material that can be found in *Skin in the Game*; a book made more enjoyable by enjoyable takedowns of macroeconomists, Stephen Pinker, Sam Harris, rent-seekers, and other targets of his ire. Enough of his system has been sketched, however, to make it clear that the remaining 80 per cent of the book is also valuable. Taleb is essential to understanding the pathologies of the post-GFC world, run by IYIs who decry populism, while aiding and abetting the 'too big to fail' managerial class making life worse for consumers and citizens.

If we're ever to force some humility on decision-makers, and enable ordinary people to regain power over their lives, Taleb's intellectual models and powerful rhetoric will help us do so. Or, if you're young and courageous enough to really take Taleb's advice, forget about programs of political change and just focus on your own life, following these rules:

1. Never engage in virtue-signalling
2. Never engage in rent-seeking
3. You must start a business: put yourself on the line, start a business

He says: '... courage is the highest virtue. We need entrepreneurs!'

Follow those rules, and you will have skin in the game.



Good luck!

This review first appeared in the October 2018 of the [IPA Review](#).