

# Black Swans and the Global Financial Crisis

Keith Rankin, 12 December 2013

One of the more interesting recent economic metaphors is that of the 'black swan'. It is used to mean an unknowable event; or at least an event deemed too unlikely to be predictable by any academic model. Like rain from a blue sky.

The economic use of the metaphor was coined by Nassim Nicholas Taleb in 2001, and became well-known after the publication of his 2007 book *The Black Swan*. Taleb is a good writer; an economist with a philosophical bent, which appeals to me. Nevertheless this seems an unfortunate metaphor given that the black swan is by no means an unknowable bird.

Black swans have been known by humanity for 50,000 years, and knowable by all of humanity for 250 years; probably longer. The first European to see a black swan was most likely a 17th century Dutchman coming ashore in New Holland. In *The Black Swan*, Taleb digs himself a somewhat racist hole when, in acknowledging the existence of black swans in Australia, he comments on their reputed unattractiveness. We shoot black swans, don't we?

It is supposed by many economists (for example Tony Cleaver in *Understanding the World Economy* 2013 edition) that the 2008 Global Financial Crisis was a "black swan event". Economists' defence in not predicting that crisis is that it was not predictable. That's bollocks!

The problem is that neoclassical economics – the most substantial offspring of a liberal (now neoliberal) project that was given its kudos in the 1690s by the philosopher John Locke – casts a blue light on the world. Thus it can only investigate phenomena visible through a blue filter.

Blue illumination may be better than no illumination. But in the 21st century the continued refusal to examine the world without anything but blue light is simply a case of 'wilful blindness' (to use the title of Margaret Heffernan's 2011 book). There really is a red 'elephant in the room' and a green one too, both invisible in blue light.

The red elephant is inequality and debt. The green elephant is the wanton and unsustainable exploitation of the natural environment. While these problems are understandable and soluble, and there's no shortage of people reporting both of them, they remain invisible in blue light. Poverty? That's just nature at work, isn't it? Environmental services? They are free on a first come first serve basis, to be exploited as quickly as possible, are they not?

Given the publicly-available information at the time, only a blind fool (or a fool too preoccupied to absorb the available information) could not predict in the early-mid-2000s that a financial crisis would happen. The difficulty was in predicting precisely when.

The financial world is not particularly perturbed by debts that are never likely to be repaid. A debt to one party (debtor) is an asset to another party (creditor).

Creditors only worry when their assets are devalued, and that happens when a sufficient number of people know that the default risk surpasses a threshold. In 2007 the actual levels of default risk on debts secured on real estate and on equities was extremely high, but an insufficient number of people knew this. By September 2008, however, the blindingly obvious (except to the blind) became blindingly obvious (even to the blind). Only then did the market supply of overpriced financial assets exceed the demand for them, and the process then became self-fulfilling.

What other black swans are lurking on our societal lagoons? Many wars have been classed as black swan events: for examples, World War 1 in 1914; the Yom Kippur War of 1973. And of course the 11 September 2001 attacks on New York and Washington.

All of those were brewing in the background with plenty of signs visible to those willing to see. And many did see, but were not heard until afterwards. What was really unpredictable was the 'when', not the 'whether', and of course the specific form of the event. Once unleashed, the ensuing sequence of violence and opportunism arising from such events does become completely unpredictable; predictably unpredictable, you might say.

On the war theme, what seemingly unlikely conflict might break out and escalate in, say, the 2020s? Maybe political and economic tension between Japan and China may escalate into something very big. There's plenty that's unresolved in that particular geopolitical setting, and alliances between the powers could draw in other participants. Indeed World War 1 still remains an unfathomable event to most of us; a geopolitical event we could yet learn much from.

In demography we have all the platitudes about ever-increasing life-spans despite so much evidence that growing debt and inequality can be quite devastating to the health of the masses.

The breakdown in a decade or two of our public health-care and ancillary sectors seems a near certain thing, in light of both the blue ideology of fiscal austerity, the increased demands that will be placed upon these services, the waning effectiveness of antibiotics, and the already present obesity and diabetes epidemics. While many have warned already, the official blue-rinsed truth is that the average life expectancy of a person born in 2013 will be well over 90, and that we should plan for that as if it was a certainty.

And what about repeats of the global financial crisis? A brief study of financial history prior to the 1940s suggests that crises like that of 2008 will recur, probably with increased intensity, about every 10 years. Indeed, so long as miserliness and inequality – the root causes of these debt crises – continue unabated, repeated financial crises are sure bets to any competent gambler.

-----

Keith Rankin teaches economics at Unitec.