RESILIENCE

BUSINESS HORIZON QUARTERLY

LONG LIVE THE RISK TAKERS

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For most of history, people lived day-to-day. Their goal was survival, living to see the next sunrise. Hunt, gather, hunker down, and avoid danger—that was the only answer. One small slip, one cold winter, one encounter with infection could mean the end. Life was simple, hard, brittle, and short.

Modern life is just the opposite—complex, comfortable, and about three times as long. Our capacity to bounce back from loss or harm—one definition of resilience—has become infinitely greater.

Consider the latest Federal Reserve figures on the American balance sheet. For all the recent trouble in the U.S. economy, household assets stand at a robust $83.7 trillion, or 523% of GDP. Household liabilities are just $13.4 trillion, leaving a net worth of $70.3 trillion. Add in business and government liabilities and the total U.S. debt burden is $40.6 trillion, or 254% of GDP, which is still less than half of household assets.

These U.S. assets, despite a severe plunge in value during the financial panic, helped sustain a reasonably high standard of living for most of the country. Some would also argue that U.S. government spending and extraordinary monetary policy helped replace lots of lost purchasing power as the private economy suffered historic unemployment and deleveraging. China, meanwhile, fought the global deleveraging by encouraging much more bank lending at the very time the world’s banks were retrenching. This countercyclical policy—a form of resilience—was only possible because of China’s fast growing economy that had been building wealth for the last three decades.

Wealth, however, can be a double-edged sword. With wealth comes resilience and thus an increased capacity to take risk. More risk can lead to further riches. Yet greater wealth also increases potential losses. In other words, we have a lot more to gain and a lot more to lose.

Perhaps it is not surprising then that many modern elites and policymakers see danger around every corner—from terrorism to climate change to financial calamity. In one sense, an obsession with risk is a luxury of wealth. It is prudent to identify present shortcomings and contemplate future problems and attempt to avoid them. Preventing hunger, unemployment, bomb plots, wars, and financial panics is a good thing.

What happens, though, when we develop a hyper-focus on shortcomings and potential losses? What happens when we seek a public policy remedy for every perceived problem? This kind of obsession with risk, danger, and downside may be counterproductive. It may exacerbate known problems and unleash dangers never dreamed of.

Why would this be the case? It is because true economic resilience is a bottom-up, not top-down, phenomenon. It comes from individual initiative, organic cultural capital, multipath redundancy, and widespread wealth. It depends on a few stable institutions that loosely organize basic ideas, rules, and customs. Beyond these basics, however, resilience is a decentralized phenomenon. Resilience cannot be commanded, it can only be encouraged.
Consider the Basel banking regulations that were meant to ensure healthy, resilient banks. The regulations were intended to cushion the downside in a financial crunch. Instead, I would argue, the rules helped cause a financial crunch. By steering all banks down the same narrow path (namely, triple-A mortgage securities), the rules reduced the diversity of investments and concentrated risk. Regulations, which encourage homogeneity, often have this effect. Insisting on conforming behavior is supposed to prevent individual failures, yet “putting all your eggs in one basket” can increase the risk of large failures.

This is ironic because individual failure is a core competency of capitalism and a key component of resilience. Wealth is about creating new ideas. New ideas can only emerge through experiments of science, technology, and enterprise, all of which must be capable of failure in order to generate newness. Failure flushes away bad ideas and points us toward good ones. The failures may at times harm individuals and waste resources—people lose jobs and investments can be lost. The larger effect, however, is to lift the economy to a higher plane of knowledge, efficiency, and resilience.

Nassim Nicholas Taleb, the financial trader turned author of books such as “The Black Swan”, argues that this process leads to something even better than resilience. He calls this higher objective “antifragility.” Resilience, in his telling, is the ability to snap back into shape. It is resistance to damage. Antifragility is improvement with damage.

An analogy might be made to the biological process known as hormesis, in which small doses of toxins or radiation can improve function and inoculate against more severe exposures. In the same way, Taleb argues, stressors toughen people, companies, and cultures. Adversity builds character. Smallness promotes agility.

Key to this formulation is decentralized information and experience. Bureaucratic design is less likely than successful culture to promote healthy behavior. Entrepreneurship is more likely than centralized economic management to produce innovation and wealth. Imprecise heuristics are often more accurate than hyper-precise expertise.

Today, vast industries, from finance to security to politics, focus on risk management. Government seeks to insure against any hardship at all. Expert agencies attempt to design perfectly competitive industries with no waste, redundancy, or profit—or they confidently impose severe costs on today’s economy in an attempt to tune global
temperatures a hundred years from now. Yet what impact do these costs have on the wealth that is needed to provide for social safety nets, insurance, and security?

A tension exists between security and risk, efficiency and creativity, resilience and innovation. We use the fruits of risk and innovation to purchase security. This security is often a good buy. Yet when a law seeks to improve the resilience of a worker’s job by making it overly difficult to fire workers, we are not surprised when fewer workers are hired in the first place. A much better form of resilience for workers is robust economic growth, which provides opportunity and choice.

Today we see wealthy societies that, over time, arguably purchased too much security. It is not an easy switch to flip back. Their economies suffer, in part, from an atrophy of aspiration.

Europe, for example, may be less resilient today because it indulged in “too much resilience” over past decades. Trying to rectify every social shortcoming can subsidize anti-resilient behaviors and discourage risky endeavors. It can deplete human capital and a culture of enterprise, which are the chief sources of wealth and thus true resilience. Likewise, U.S. stimulus and expanded government benefits, such as seen in disability rolls and extended unemployment insurance, may have interfered with the American economy’s natural healing networks of human capital and enterprise.

Where Taleb’s stressors keep us sharp, tough, hungry, and resilient, purchased comfort can lead to just the opposite. Entrepreneurship is the driving force of growth, but also, through its orientation toward future possibilities, supports the asset values of today. It is a future orientation that not only builds the future but sustains the present.

This is the enigma of wealth. We work hard to generate wealth so we might enjoy comfort. Yet today’s comfort can be the enemy of tomorrow’s. Wealth, or resilience, is not a haven but a process of constant regeneration.

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