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So many bad decisions, so little time

A fatal conceit is the undoing of many a politician

By: Richard Rahn
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Would you have traded five terrorists for Sgt. Bowe Bergdahl? The decision may have been wrong or right, but what is striking is that President Obama seems to have made this decision, and all too many others, in an ad hoc way, rather than using decision theory.

Decision theory is an orderly way of thinking and choosing among alternatives when there is a number of variables for which the probabilities of each may or may not be known to the decision-maker. A related concept is that of "regret," which is the difference between the actual payoff and the best one. In the Bergdahl case, as the president has acknowledged, there is a risk that some of the released terrorists may go back to their old ways and kill Americans. The president put a low probability on that outcome. Yet some CIA officers put a high probability on that outcome. How much "regret" evaluation did the president and the CIA do in coming up with their conflicting judgments?

Politicians and criminals both have a tendency to underestimate the probability of getting caught in bad acts. Is it because few studied decision theory or because there is a certain recklessness in the nature of those who follow such pursuits? We know from empirical evidence that very visible politicians have a high chance of getting caught with their pants down (so to speak) — think of Bill Clinton, John Edwards and Eliot Spitzer. President Clinton managed to get himself impeached, indirectly, over an act of momentary pleasure — and, even though a smart guy, he underestimated the probability of being caught.

Almost everything we do has costs and benefits. Getting a college education has costs before the benefits, while drinking too much at a party often appears to have benefits, but the costs come due the next morning. There is a natural human tendency to overestimate the benefits of various anticipated actions and to underestimate the costs. This applies to government regulators. The president tells us how concerned he is about global warming, yet the measures that his own administration has implemented and is trying to impose will cost hundreds of billions of dollars, if not trillions, and by its own estimates, will only reduce temperatures by two-tenths of one degree in 100 years. In essence, no real effect at all.

The Internal Revenue Service is forcing reporting measures on most foreign financial institutions. The net result will be to kill more foreign investment and jobs in the United States than the little tax revenue the regulations are designed to bring in. The government can spend taxpayer dollars on many different things, such as highways, medical research, vouchers for veterans or reducing the deficit in order to try to avoid a major financial crisis. A rational government tries to allocate the limited taxpayer dollars and mandated expenditure of private capital to the highest and best use. The failure to do so is nothing short of policy malpractice.

Both individuals and government leaders make many bad decisions because they let emotion or ideology override reason and empirical evidence. Such behavior is usually self-destructive. I refer to this as the suicide gene. For instance, there is overwhelming empirical evidence that total government spending as a percentage of gross domestic product is far above the optimum rate for economic growth and job creation, and that the maximum marginal income-tax rates are well above the revenue-maximizing rate. What actions do the president and Democratic Congress take — they increase spending as a percentage of GDP and increase tax rates. They now seem perplexed about the slow rate of economic growth. Now as a result, many are likely to lose in the next election.

New lovers are notorious for underestimating what can go wrong — usually, because the parties choose to be willfully blind to and discard uncomfortable variables as part of the decision matrix, preferring wishful thinking. Hillary Clinton's Russian "reset" comes to mind.

The great 20th-century economist and philosopher F.A. Hayek wrote about the limits to knowledge and a fatal conceit to help explain why big government and socialism fail. In essence, Hayek correctly argued that politicians and bureaucrats assume that they and their immediate colleagues can know enough to manage large and complex organizations well, particularly in the absence of good market-derived price signals. Obamacare is a prime example. It is so complex no one can fully understand all of the pieces and their interrelations, which is a major reason they could not build a highly functional website. Yet the president and many in Congress had the fatal conceit they could manage one-sixth of the economy.

Arguably, the world's greatest chess player of all time, Gary Kasparov, has an incredible ability to see many moves ahead. If President Obama and Russian President Vladimir Putin were to play chess, who would you bet on?

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