ECONOMICS AND FINANCE: THE MONOPOLY AND DANGERS OF THE MAINSTREAM SCHOOL OF THOUGHT*

Marc Chesney

ABSTRACT

The academic world is too often disconnected with the needs and realities of the economy and society. It has not sufficiently drawn lessons from the 2008 financial crisis, and repeatedly demonstrates great restraint when faced with financial scandals. Its responsibility is, however, to analyze these problems and to argue objectively.

To make sure academic freedom is not merely empty words or a pleasant principle inscribed on university pediments, it must be exercised and practiced regularly by faculty members. The field of finance addresses the issue of (asset) prices but does not transmit values. Money is presented implicitly or explicitly as an end rather than a means.

Keywords: Academic freedom; financial scandals; crisis; systemic risks; Chicago school; interdisciplinarity

TEACHING FINANCE: DID THE 2008 FINANCIAL CRISIS TAKE PLACE?

Reading through numerous course syllabi and teaching manuals, the question is raised as to whether a crisis indeed took place in 2007 and 2008.[1] Many examples

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can be identified among prestigious universities both in North America and in Europe.[2] When comparison is possible, pre-crisis and post-crisis course outlines most often confirm substantial inertia among teaching faculty. Generally, the financial crisis is either absent from these syllabi or only appears succinctly. In some cases, the topic emerged shortly after the crisis but then disappeared entirely a few years later. Questions regarding ethics and sustainability are not addressed in most Master's in Finance programs. Initiatives aiming to update current teaching exist nonetheless but stem from personal decisions taken by various professors or university heads.

Mathematical finance constitutes a notable example. John C. Hull's book, *Options, Futures and Other Derivatives*, is presented as the bachelor student's indispensable reference guide to derivative products and is, therefore, used extensively in numerous universities, including ones in Switzerland. The second edition, published in 2018, consecrates only around 3% of its 851 pages to the key role these products played in triggering and propagating the crisis.

It is interesting to note that when the author alludes to the financial crisis, he states, 'clearly, the first decade of the 21st century was disastrous for the financial sector'. This leads to one remark: making reference to a disaster for systemic banks bailed out with public funds is a falsehood. On the contrary, it was a disaster for taxpayers who had to pay the bill as well as for some 30 million individuals across the globe who lost their jobs, without even talking about those who lost their homes.

Moreover, the author regretfully acknowledges that some companies are considering limiting or even completely eliminating their purchases of derivative products. He points out that these allow firms to manage their risks. Oddly, he neglects to indicate that these products correspond to nine times global gross domestic product (GDP) which is entirely disproportionate. Such management should only require a fraction, somewhere between 30 and 60% of global GDP, but not nine times more. Such a volume generates systemic risks for the economy and society. Financial institutions who issue them behave like pyromaniac firefighters. They sell products that should allow companies to hedge themselves against financial risks. Issued on such a scale, they generate considerable systemic risk against which companies need to hedge themselves… Unfortunately, these points are not addressed in this book devoured most often uncritically by generations of finance students.

The book, *Principles of Economics, A Streamlined Approach*, by Ben Bernanke and his three co-authors constitutes an additional telling example. In the 2017 edition, the 2008 crisis is not mentioned in the book's description as if the anchored economic principles were in weightlessness over a context of profound financial instability.[3] This illustrates the refusal to adapt rigid concepts and supposed fundamental laws of economics to a dynamic context of dangers and systemic risks which do not cease to propagate. Ben Bernanke, Chairman of the Federal Reserve (FED) from early 2006 until early 2014, is in an ideal position to carry out a thorough reflection on the financial crisis of 2007–2008 and draw lessons from it. That would have been highly valuable both for students and for the broader public.

IS ECONOMICS STILL A SOCIAL SCIENCE?

The Chicago School continues to dominate debates and de facto holds a kind of monopoly. It controls the so-called A journals, assumed to define scientific excellence in the field. Recent publications are given too much weight. Collective amnesia is setting in. Key authors are disregarded. Their contributions, as works of reference, do not conform to the straitjacket of A journal publications.

Today, topics covered are too often disconnected from pertinent economic and social issues. There are many examples of abstruse title articles.[4] Fundamental debates are simply dismissed. They would disturb an academic economy and finance frozen in their dogmas.

Contrary to physics, there are no fundamental laws of economics or finance. Pretending the opposite allows these disciplines to present themselves as sciences and to refer to the 'laws' of a financial sector out of control, conforming exclusively to its own interests. Attempts to discuss, contradict or question are marginalised and ostracised. Employing pseudo-scientific jargon impresses people rather than convincing them. The structure of research has taken on a mathematical appearance. Theorems are all too often proven without verifying the truth, in other words the realism of their assumptions. This work, incumbent upon econ and finance professors, is only rarely accomplished.

Economics, which is a social science, should adapt to the evolution and needs of society. This is far from being the case. Economics is disconnected from its basis: precisely society and the environment. Economic and financial policies presented as beneficial too often have a potentially detrimental social and environmental impact!

Numerous concepts and assumptions are ill-adapted to the current situation and hardly realistic.

- Financial markets are in principle right, perfect and efficient, like gods. They have become the alpha and omega of a new religion to which people are supposed to adhere, despite the obvious contradictions between what it preaches and its daily practices. How can one still believe in the supposed financial market efficiency when these markets are manipulated on a large scale? There are many examples: LIBOR, currencies, high frequency trading and its associated front running, as well as so-called unconventional monetary policies, resulting in negative interest rates in some countries, which reflects a major economic dysfunction.[5,6] The interest rate represents the price of money. A price that remains negative for such a long time can only stem from massive manipulation by Central Banks of relevant financial markets, in this case, the bond markets.
- The existence of risk-free assets required in numerous financial models. Does such an asset exist today? A Swiss–US Treasury bondholder takes on currency risk. The holder of a Swiss bond will certainly lose money given negative interest rates. This is even worse than the risk.
- The absence of arbitrage opportunities. Obtaining prices for derivative products, far from being based on supply and demand, is rooted in this unrealistic

hypothesis. The daily modus operandi of hedge funds and big banks precisely involves exploiting arbitrages or creating them.

- 'Always more' is synonymous with 'always better'. According to Milton Friedman, a company's only social responsibility is to increase its profits and create shareholder value.[7] Greed is, therefore, adorned with many virtues.[8]

ESSENTIAL OVERLOOKED TOPICS

Some topics are overlooked or taboo. As a result, debates focus too often on minor themes rather than essential subjects.

- The role of finance. Should it serve the economy or serve itself?
- Are values uniquely financial? What about those who confuse being with having or appearing, and who accumulates absurd amounts of wealth?
- The intended trickle-down effect which should result from this accumulated wealth is a lure. Rather than obeying the law of gravity, wealth moves towards the top of the social pyramid.
- How can the enormous financial flows be directed towards the fight against global warming, deforestation and pollution, and be transformed into investments in these areas?
- What are the social consequences of reducing citizens' role to one of consumer, producer or financial intermediary? Functionalising humans generates a fragmented society comprising isolated individuals, democratically fragile and conducive to the development of totalitarianism.[9] In this context, what do citizens transformed into 'agents' have in common? Transactions in manipulated financial markets and ruthless profit optimisation divide them instead of bringing them together.
- Is economic growth always possible and desirable? The mainstream paradigm lies in a debt-growth dualism. The first component would be useful in attempting to relaunch the second, and growth would be necessary in order to try to reimburse part of the debt. Yet, global debt represents approximately 360% of GDP and, given Covid-19, is increasing at an even faster rate. This paradigm clearly does not work. A new one is necessary.
- Interdisciplinarity must be introduced. Growth, already mentioned, is an interdisciplinary topic. Its limits, particularly environmental, must be recognised. The question of growth is multidimensional. It involves economics as well as ecology, biology, history and philosophy. Neither human beings nor societies can grow indefinitely. Moreover, this would not be desirable. A series of phases, growth, stabilisation and decline, is the norm.
- Promote pluralism in terms of schools of thought.[10] Competition, often emphasised in economics, is strangely missing in this area. The Chicago School exercises a kind of monopoly. It would certainly be useful to demonstrate interest in other schools of thought, to possibly develop a new one as well as alternative paradigms in today's finance casino context.[11]

- Identify concepts and models that are meaningful and those that no longer are. Establish new ones that are pertinent to society.

CONCLUSION

An ambitious program is required. It involves nothing less than a commitment to profound reflection on teaching content and concepts conveyed in economics and finance in such a way that they are updated and aimed at the common good. It is the responsibility of the teaching faculty vis-à-vis students, taxpayers and society as a whole.

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NOTES

1. See Chesney (2010, 2011, 2018).

2. At Berkeley, for example, neither the financial crisis nor associated topics such as financial instability appear on the syllabus of the bachelor course, Introduction to Finance. This was also the case for the MBA course, Core Finance, in 2016. In 2009, the University of Michigan's Ross School of Business proposed a 'Special lecture on the financial crisis' for its Financial Management course. This is to be applauded although it only involved one session during the semester. Two years after, in 2011, this lecture disappeared from the syllabus.

3. It is worth noting the exorbitant price in this textbook: between 213 and 289 dollars!

4. Here are examples of some article titles in the *Journal of Economic Theory* in 2019: 'Asynchronous games with transfers: Uniqueness and optimality', 'Mechanism design with ambiguous transfers: An analysis in finite dimensional naive type spaces', 'Learning to believe in simple equilibria in a complex OLG economy – evidence from the lab', 'Leverage dynamics and credit quality', 'Majority rule in the absence of a majority, Private communication in competing mechanism games'.

5. The LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.

6. Very often, big banks carry out high frequency transactions at clients' expense. Stock prices are manipulated when, for example, a series of buy orders in milliseconds, given with the objective of increasing the price, is suddenly cancelled making way for a sell order at a favourable price.

7. IBM's immense earnings from vast business dealings with Nazi Germany constitute an extreme example of a strategy uniquely focused on profits. Thanks to this collaboration, this regime's extermination machine became particularly effective (see Black (2012)). Without a moral compass, greed leads to the worst.

8. I quote: 'Gier ist nicht einfach schlecht' (greed is not simply bad), see Degeorge (2018).

9. See Arendt (2017).

10. See Bürgenmeier (2019).

11. In the context of finance casino, the foundations on which our economy has developed, namely savings used to finance investments, trust and responsibility tend to be replaced by large-scale financial bets, indebtedness, cynicism and losses spread among society.

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