Is Financial Innovation a Curse?

This omnipotent finance achieved its absolute domination from computers which prevail today on stock market fluctuations, and therefore on the capitalization of our businesses. How else can one explain that large cap securities such as Société Générale or the Italian bank, Intesa Sanpaolo (and several other well-known institutions) can sell 15% in a single session? What is behind the collapse of Bank of America’s shares by 20% in a single day? Or behind a Dow Jones index which can fluctuate by more than 400 points upward and then downward over the course of several days? They are in reality robots which, with the assistance of algorithms, issue buy and sell indications since 55% of the volumes dealt with today (as opposed to 20% in 2005) on all U.S. financial markets are the sole responsibility of machines! Everywhere, grey matter seems to have disappeared since everyone – banks, speculative funds and even pension funds – is now addicted to this “trading algorithm” which makes the Dow Jones lose 1,000 points in the space of a few minutes (the famous “flash crash” on May 6, 2010). The economist Heilbroner (1919-2005) maliciously said at the end of his life that mathematics had breathed stringency into economic science before killing it! These algorithms that control this “high frequency trading” further allow their instigators to reap huge profits daily. Or losses when the system catches a cold, such as Knights Capital losing $440 million in 45 minutes in the summer of 2012! In reality, this algorithm trading enables its originator to intervene prosaically between a buyer and a seller to pocket a small margin… except that it is about a commission charged on thousands – even on millions – of transaction. It is the entire profession which must now recognize that it erred in its assessment of a highly complex system… that it did not always understand it! Indeed, these flagrant technological advances are exploited by the financial world precisely with the objective to go around – even breach – regulations. As John K. Galbraith (1908-2006) suggested, it is vital to gauge and dissect financial technology within a legal framework so as to understand the most complex instruments. This sophistication with financial tools is being knowingly developed by a financial sector concerned with evading the law. Let us well understand that, in the globalized financial world, fraud is not an anomaly: it is an integral part of the system, it is one of its undisputable components. Suffice it to say
that we need only look at the jargon being used in the mid-2000s to understand – thanks to vocabulary! – that the financial stakeholders knew perfectly well that they were distributing suspect and unsavory financial products. They were “neutron credits” intended to crumble without causing their downfall in the housing market. They were “ninja credits” whose poor beneficiaries had no income, no job or assets (No Income, No Job or Assets). They were “liars’ loans” since everyone knew that the person applying for credit had lied on his application… So many instruments directly led to the “subprime” disaster and showed that the financial world was perfectly aware of the explosive matter that it manipulated.

Will economic “science” one day have the same fate as anthropology and phrenology? In other words, will economic science ever become a fossil science, vaguely respected for what it will have brought but completely out of date? Leverage, derivatives, derivatives, also known as “exotic” products, options, knock-out, knock-in, one touch, futures, futures markets, securitizations… Must we destruct all these financial innovations? Should financial science be regarded with suspicion when it innovates? It is indeed impossible to tolerate more sophisticated – even decadent – financial products whose only objective is very often to enrich a certain class. Does it make sense to devote much public contempt to all financial inventions which bring marked improvement to our standard of living? After all, no one thinks to condemn the Internet, the basis of the collapse of the bubble of the technology stocks? Furthermore, had not the principle of a limited company and stock market capitalization been confronted with great distrust during the 19th Century by those who were persuaded that it would allow it would allow the emergence of entrepreneurs eager to shirk their obligations? Unlimited personal liability was in place at that era. Can you imagine today’s economic and business world functioning without limited liability companies and the stock markets? As well, excessive credit is certainly the origin of the property frenzy whose decay (since 2007 with the crumbling of sub-primes) led to today’s crisis, but did credit expansion systematically degenerate into a speculative bubble?

Instead, is it not from the moment when a security is converted into a security of securities and is cut into tranches to be resold to several stakeholders that from that point the banker believes himself invincible and that all hope begins to be vain? Indeed, all financial innovations do not apply: easy and traditional access to credit undeniably makes society advance when it is used to purchase one’s home or finance one’s studies. However, this same credit spent on refined products becomes disastrous if used for market speculation or to adopt irrational behavior and devoid of any economic justification. Thus, while finance can actually
make our world better whereby our huge middle class as well as the most needy can legitimately improve their standard of living, it can become a weapon of mass destruction when a few among us use it for unsavory purposes. Therefore, is this financial innovation or its specific applications, at the behest of greed and immorality of a business minority, which are harmful to the system and society? Sub-question: what is the overall balance sheet of the value of financial innovation on the real economy? If financial techniques only marginally benefit society during good times, its ability to harm is, however, disastrous when the train derailed! It is therefore imperative that we – even – this world of finance which saw spectacular expansion and whose contribution to the GDP of our developed countries steadily climbed for 150 years. What, therefore, is really the added value of finance and how does it benefit economic productivity? Should we, after Paul Volcker, former Chairman of the Federal Reserve Bank and advisor to the Obama administration, assert that the only tangible asset of finance is the automatic distributor of bank bills? The answer is still pending and doubts are allowed since yesterday’s prosperity was the pretext for all sorts of predatory behavior on the part of individuals and entities that ruined the system, with the blessing of our politicians. So, it had been explained to us that profit should be the only horizon, that it was legitimate that this sole purpose – “worthy of respect” – underpin and feed our energy and thirst for success. It is clear today that this quest for profit destroys our lives and our planet. Worse yet, that it threaten our individual freedoms! The devotion of the Anglo-Saxon social model, having excessively boosted trade and consolidated all types of businesses into massive conglomerates, proved to be a failure for long-term growth and harmful to society. This philosophy turned us into psychotics (“sociopaths” in the words of Nassim Taleb), which vie with imagination to destroy value and – even more serious – values. This dogmatic eagerness to “laissez-faire” finally resulted in tyranny, when it was, however, so much healthier to have the largest number participate in leading business and businesses. The markets accelerated the advent of macro-management – that is to say, oligarchy – whereas only micro-management leads to stability and production of individuals. The academic world, that of business such as our economic authorities all depart from the principle that it is better to promote large organizations and banks when (and even if) they are known to have lost almost all sense of collective responsibility. In so doing, these cartels and concentrations of power, which instill foul air on all economic activity, slowly kills private initiative while compromising our individual rights. That is why it serves no purpose to believe today in the illusions of those who pretend to “reinvent” capitalism since – and it is Marx himself who recognized it – capitalism is always reinventing
itself. Indeed, constantly changing, it is eternally in search of new artifices, new techniques and sophistication, sometimes extreme, with the single objective of optimizing its profits and satisfying the instinct of accumulation. Moreover, each stage of its metamorphosis throughout its history was systematically punctuated with corruption and outrageous exploitation.