

Frank Jan de Graaf argues that the domination of neoclassical economic thinking in academia has contributed to the economic crisis

Economics, scientific doubt & history.

Alan Greenspan
former chairman of the
American Federal Reserve

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The most impressive mea culpa of the past year was undoubtedly given by Alan Greenspan, former chairman of the American Federal Reserve, or central bank. In a hearing before Congress on the credit crisis, he stated: “I have made the error to expect that the self-interest of organisations, especially banks and others, was the best way to protect shareholders, capital and business...”

In reply, the chairman of the committee asked if he felt that his view of the world, his ideology, was inappropriate and had failed. Mr Greenspan agreed.

With his apology Mr Greenspan recognised the failure of the neoclassical approach to economics, which assumes that the rational, selfish behaviour of people in free markets ultimately leads to the highest social usefulness.

It must have been a shock to the economics of the past few decades. Subjects such as public finance, corporate finance, banking theory, risk management and management accounting are all largely based on the neoclassical approach. Most recent appointed professors have started their work with ideas based on a neoclassical fundament and its methodological preferences.

Neoclassical economic thinking is not bad in itself. It has brought much good, even.

In the 1980s politicians such as Margaret Thatcher in Britain and Ronald Reagan in America got their economy back on track based on neoclassical theories. At the time economic thinking in many Western European countries was still dominated by Marxist and socialist thinking.

Despite the current criticism, radical policies proved to be a blessing in the long term.

But now the downside of neoclassical theory has occurred. Failing financial markets have plunged the global economy into crisis.

It is, therefore, high time for a debate on economic concepts as taught in universities and business schools. Are students really trained to think critically about economic theory and the consequences when economic theories are put into practice?

Such a debate must focus on the sustainability of four assumptions behind current economic science.

In recent years, students have learned that the economy is made up of (1) rational individuals seeking (2) maximum satisfaction who are (3) fully informed in a (4) market that strives for equilibrium.

This has led to a generation of economists who believe in market forces but who can