

BOOK REVIEW

Silver, N (2017). *Finance, Society and Sustainability: How to Make the Financial System Work for the Economy, People and Planet.*

Palgrave Macmillan, London

This book puts the financial services industry of the 21st century under the searching spotlight of an actuarial author whose experience and scholarship are both broad and deep. Notwithstanding some shortcomings in the writing, it is an important contribution to our understanding of the system within which we work and which defines our paradigm. It is important reading. In this review I first outline the author's analysis of the problems with the financial services industry. Then I discuss his accusation that the financial services industry is sucking the system dry. And then I outline and comment on his proposals to fix the system. I raise some quibbles regarding the textual shortcomings. And finally I draw some conclusions.

Problems with the financial services industry

The author has five theses, to each of which he devotes a chapter with a catchy title. He summarises them in Chapter 1:

- “Potemkin markets”: Russian Prince Grigory Potemkin built a mobile village to fool his beloved Catherine the Great into thinking he had rebuilt the recently conquered Crimea. The author argues that capital markets, far from being free, are dominated by governments, which fool market participants into thinking their market is free.
- The “Sisyphus savings system”: Sisyphus was punished by the gods to be condemned for eternity to push a boulder up a hill and watch it roll down again. The author applies this metaphor to the failure of governments, due to low interest rates and high charges by the financial services industry, to encourage people to save for retirement.
- “*La grande illusion*”: The illusion is that savings are being invested in the real productive economy; he argues that only 4% is so invested. This illusion is reflected in the failure of the financial services industry to invest society's excess earnings because of the concentration of power to asset-management intermediaries and their ability to intercept savings and manage them, particularly by investing in mortgages on fixed property, so as to maximise their own revenue.

- “A kind of magic”: The “magic” fools economists into thinking that banks are merely intermediaries between depositors and producers. It enables the banks to create money and to distribute it so as to maximise their profits.
- “Helminths”: A ‘helminth’ is a parasitic worm. Financial agents parasitise the system by using leverage, financial innovation, power over commerce and industry and government, which he refers to as ‘colonisation’, and the dominance of their discourse, which he refers to as ‘hegemony’, to maximise their own revenue.

Sucking the system dry

To me the author’s argument that the financial services industry is sucking the system dry is particularly important. In Chapter 4 he presents estimates, in various articles, of annual fees, i.e. “reduction in yield” on public equity funds. They range from 2,3% to 3,1% a year. For a reduction in yield of 2,7% he has estimated the charge ratio, i.e. the reduction in maturity value—though he includes post-retirement deductions—at over 60%. These figures are considerably higher than Murthi et al.’s (unpublished) estimates for the UK in 1998 cited in Rusconi (2005: 69–70), which suggested a charge ratio of 25%. The differences may relate to changes over time, differences in assumptions and methods, the types of contract included, the information available and the inclusion of post-retirement deductions. But whatever the explanation, the charges are exorbitant.

In the introduction to Chapter 7 on the economy’s helminths he asserts:

... the purpose of the finance sector is to maximise its own revenue [and this] is achieved by agents in the financial system managing capital stocks and flows in the economy in such a way as to generate revenue for themselves.

I take no issue with his accusation. But he goes on to state:

... finance firms are not looking to do good or bad; they are amoral—a firm is a legal entity, not a moral agent.

To me this is typical of the hegemonic discourse of neo-classical economics. It appears that the author has unwittingly fallen into the very trap that he has so convincingly described. He then elaborates on this theme:

In suggesting that the finance sector behaves in this way, I am not suggesting that individuals or companies are consciously subverting the economy, but this is the aggregate impact of individual decisions to maximise financial actors’ own revenue.

In other words, he is saying that you can’t blame parasites for being parasites. The problem with this argument is that financial professionals are supposed to be professionals, not parasites. The professions are supposed to be there for the public good. And unlike helminths we should have had sufficient analytical ability to see when we were sucking the system dry. Now the damage is done; as he points out at the end of Chapter 7: “We have a dysfunctional finance system.” But he continues:

... we have handed the controls of the economy to the finance sector, [who] have made themselves all-powerful and now dominate the political discourse...

This, it seems to me, contradicts his argument that the capital markets—the “Potemkin markets” as he calls them—are dominated by governments.

In Chapter 8 he argues:

The world is awash with savings, we have a saving’s [*sic*] glut which is the subject of much angst amongst economic policymakers. Yet this is not translated into sustainable investment. Why not? Because the controls of society’s investment are in charge of the helminth, for whom it is more profitable to create artificial assets than [*sic*] it is to actually make investments.

When I studied economics I was taught that, in a closed economy such as the world economy, investment during a specified period must equal savings during that period. This doesn’t seem to be true in the author’s world. Even in an open economy such as the UK’s or South Africa’s, consumption plus savings must equal production plus investment. The disparity between savings and investment cannot be greater than the disparity, due to international trade, between production and consumption.

Otherwise, his argument is generally convincing. As an actuary one is left with a profound sense of unease that, as comrades used to say during the anti-apartheid struggle, we are “either part of the solution or part of the problem.”

Proposals

Chapter 10 sets out “some modest proposals to create a flourishing financial system”, comprising:

- scrapping pensions, because people won’t need to retire;
- draining the sovereign-wealth “swamp” of the oil producers by destroying the demand for oil;
- introducing a financial transaction tax;
- replacing fractional-reserve banking with “pawnbroker” banking, where banks pre-agree with the central bank the discount rate to be applied to the loans they have issued and in a crisis the central bank lends against these assets at the pre-agreed rate;
- using fiscal measures to encourage house-building and curb increases in house prices;
- implementing triple-bottom-line accounting;
- using “impact investment” in projects or organisations to achieve a benchmarked financial return and increased ecological and social value added;
- using “green investment” to shift investment into sustainable infrastructure;
- promoting the “circular economy” by reducing, reusing, repairing and recycling;
- promoting the “sharing economy” by sharing equipment such as cars, with producers retaining ownership and responsibility for maintenance services; and
- using “FinTech”, i.e. new technologies for financial services.

He elaborates on each of these proposals, and he discusses some of the difficulties that might arise. To my mind, the following points arise.

As regards the scrapping of pensions he asks, “Who needs a pension, anyway.” In a world in which nobody needs to work much and the distribution of wealth is handled by government, it’s a valid question. But some planning of the transition is necessary. The author happily waves his arms at the problems and dreams of a different future.

As regards accounting measures, he dismisses the use of scalar proxies for the state of the ecology and of human well-being because of his focus on complexity. I beg to differ. In fact, I think the actuarial profession has an important role to play in the formulation of scalar measures of the effects of entities’ activities on the ecology, on society and on the economy, and in the time-series modelling of those measures for the purposes of assessing the sustainability of those activities in each of those domains.

Some quibbles

It’s a chatty book; the author is “I”, the reader is “you” and the language is colloquial. But until the last paragraph, where he identifies “you” as “the financial professionals”, I was unsure who he was chatting to. Certainly it is relevant to financial professionals in general and actuaries in particular.

The text is seriously in need of editing; the grammar and punctuation leave much to be desired. His algebraic formulae are painful to a mathematically literate reader.

Conclusion

Nevertheless, the book is an important challenge to the actuarial profession; being in a privileged position within the financial services industry we must take it seriously. It’s a substantial contribution to the literature of new economics, a subject on which the International Actuarial Association’s Resources and Environment Working Group has a project. It needs to be treated as the start of a conversation of the future of the actuary’s role not only in the financial services sector, but in the measurement and modelling of the system within which it operates.

Perhaps the actuarial profession could organise a workshop on the subject. Perhaps it could commission some research on the viability of the author’s dreams and the time-series modelling of possible transition pathways. Perhaps it could include material from this book in its syllabuses. The future will not be like the past.

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