

On the Role of Paradigms in Finance

by Kavous Ardalan

Ashgate: Aldershot, UK., 2008, pp 176

reviewed by Stavros A. Drakopoulos*

The notion of the scientific paradigm introduced by Thomas Kuhn in the 1960's has become very influential in the history and philosophy of science. Kuhn's work focused on the scientific development of physics but soon it was extended by many sympathetic followers to the social sciences including economics and economics-related fields. For almost two decades, economic methodologists employed Kuhn's ideas in order to understand better the development of economics as a scientific discipline. In recent years however, the influence of Kuhn among economic methodologists seems to have weakened, mainly because of the increasing influence of more modern scientific philosophies. In spite of this, a large number of economists continue to employ Kuhnian modes of methodological explanation in almost all fields of economics. One can find recent examples from the theory of choice, monetary economics, development economics, law and economics, market equilibrium, health economics and economic fluctuations (for a general review, see Drakopoulos and Karayiannis, 2005).

The present book concentrates on the discipline of finance and it belongs to the above Kuhnian tradition. As the author indicates, this work attempts to bring ideas from the philosophy of science to the field of academic finance. In particular, it utilizes analytical tools from the philosophy of science (and especially Kuhn's idea of scientific paradigm) in order to understand better the structure and the nature of contemporary academic finance. Using the concept of paradigm, the author discusses the multifaceted nature of financial knowledge and its current organization, and ultimately recommends ways of improving financial knowledge, mainly through paradigm diversity.

The work is divided into fourteen chapters along with a fairly comprehensive bibliography. In the first five chapters, Ardalan sets the basic analytical framework and relates it to the field of finance. In the first chapter, he argues that social theory can

* University of Athens

be conceived in terms of four key paradigms: functionalist, interpretive, radical humanist and radical structuralist. This classification was first proposed by Burrell and Morgan (1979) with reference to sociology. Each of those paradigms generates theories, concepts and analytical tools which are different from those of other paradigms. In the second chapter he shows that mainstream academic finance is founded on the functionalist paradigm and this argument is further elaborated in the third chapter. In the same line, the following chapter contains a discussion of the differences in the four key paradigms and their implication for finance research. Chapter five, by examining PhD programmes, journals and conferences in academic finance, amplifies the author's argument in the second chapter that mainstream academic finance is founded on the functionalist paradigm. In the following eight chapters, Ardalan discusses opportunities arising from paradigm diversity and shows its possible benefits. In particular, he discusses the following topics from the four different paradigmatic viewpoints: development of academic finance, mathematical language and mathematics in academic finance, money, corporate governance, markets, technology, and education. Finally, there is a concluding chapter summarising the main points and offering recommendations.

The main argument of the book is that mainstream academic finance is based upon the functionalist paradigm — something that most finance theorists are not aware of. An understanding of other paradigms leads to a much better comprehension of the nature of finance research. It also implies that the pursuit of financial knowledge is seen as much as an ethical, moral, ideological and political activity, as a technical one. Furthermore, paradigmatic diversity can only be beneficial for the discipline. In general, I am sympathetic to the thesis of this book. I think that adopting a philosophy-of-science perspective on the structure and the nature of a scientific field contributes to its methodological foundations and might also lead to new research avenues. This might be especially fruitful for the field of finance given the recent criticisms connected with the economic recession. In addition, it has proven very useful in the wider field of economics. For instance, the broad acceptance of the idea of scientific revolutions in economics, such as the marginalist or the Keynesian revolutions, is mainly the product of the influence of philosophy of science (see for instance, Dow, 1985). Furthermore, the ideas of Kuhn and of other philosophers of science like I. Lakatos, provided the stimulus for work on the nature of growth of economic knowledge. In other words, they made economists think about the way that economic ideas develop (see the volume by de Marchi and Blaug, 1991).

In the above sense, the present book is a positive contribution especially for the subfield of finance in which there are not many similar works. Given that, I think that the author should have devoted more space to examining the analytical details of Kuhn's work. It seems that he relies too much on secondary works on this subject. Moreover, I think that a brief discussion of the criticisms of Kuhn's work by modern

philosophers of science would have been useful. In the same framework, there are many methodologists who think that the Kuhnian analysis is not the best approach for social sciences and for economics in particular (see for instance, Hausman, 1994). However, the author does not engage in any examination of these important criticisms.

Some of the points presented in this book have been published in academic journals by the author. However, the flow of the argument is very convincing and appealing. Another positive contribution of the book is that it draws attention to the crucial role of scientific methodology in the understanding of scientific process. In general, I believe that this is a useful book for graduate students in finance and in economics. I also think that it is particularly useful for those finance specialists who are convinced that philosophy of science and methodology have nothing to do with their subject.

References

- Burrell, G and Morgan 1979, *Sociological Paradigms and Organizational Analysis*, Aldershot: Gower.
- De Marchi N. and Blaug M. (eds.) 1991, *Appraising Economic Theories: Studies in the Methodology of Research Programmes*, Cheltenham: Edward Elgar.
- Drakopoulos, S. and Karayiannis, A. 2005, "A Review of Kuhnian and Lakatosian Explanations in Economics", *History of Economics Ideas*, vol. 13.
- Dow S. 1985, *Macroeconomic Thought: A Methodological Approach*, Oxford: Basil Blackwell.
- Hausman D. 1994, "Kuhn, Lakatos and the Character of Economics", in R. Backhouse (ed.) *New Directions in Economic Methodology*, London: Routledge.