

Economic questions: the Eugene Fama question

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This is one of a series of posts that will ask what the most pertinent question raised by a prominent influencer of [political economy](#) might have been, and what the relevance of that question might be today. There is a list of all posts in the series at the end of each entry. The [origin of this series is noted here](#).

After the first two posts in this series, the topics have been chosen by me, and this is one of those. This series has been produced using what I describe as directed AI searches to establish positions with which I agree, followed by final editing before publication.

In the run-up to tomorrow's Budget, it seems appropriate to note economists who appear to influence the thinking of Rachel Reeves and the UK Treasury, hence today's focus on Eugene Fama, the creation of the so-called Efficient Market Hypothesis, to which I was forced to give much attention as the world of finance based on it collapsed in 2008. This thinking should have been consigned to history then, but the world's financial markets still behave as if this flawed logic is true, and so, by default, do the governments of countries like the UK, which run their economies to serve those markets.

Nobel Laureate [Eugene Fama's](#) so-called [Efficient Market Hypothesis](#) (EMH) is one of the most influential ideas in modern finance. It claims that markets instantly incorporate all available information and therefore price assets correctly at all times. According to Fama, there are no mispricings to exploit, no bubbles to inflate, no systemic distortions that experts can foresee. Markets, in this view, are not just efficient; they are omniscient.

The elegance of the theory gave it enormous power. It justified deregulation. It encouraged the rise of passive investment. It offered intellectual armour to those who believed markets should be left alone, and it helped entrench the worldview that finance requires liberation, not scrutiny.

But EMH has been tested repeatedly — and reality has failed to conform. The 2008 crash should have buried it. Instead, it continues to define the architecture of global finance.

Hence, the Eugene Fama Question: If the theory that financial markets are perfectly rational collapses every time reality intrudes, why do we still allow it to shape the policies, products and institutions that govern our economic lives?

The seduction of perfect rationality

Fama's EMH offered economists something they crave: a world governed by clean mathematics and predictable behaviour. It substituted the chaos of real markets with the reassuring fiction that prices always reflect true value.

This model treats risk as calculable, diversification as infallible, and systemic stability as a natural property of unfettered markets. It replaced judgement with formulas. It replaced uncertainty with probability. It replaced responsibility with the assumption that markets could not be wrong.

This intellectual seduction continues to protect EMH long after its credibility has gone, at a cost to us all.

A theory refuted by the world it claims to explain

The history of financial markets is a record of everything EMH says should not happen:

- * Bubbles
- * Panics
- * Herd behaviour
- * Irrational exuberance
- * Crashes triggered by rumour and fear
- * Markets that inflate asset prices far beyond any plausible value.

The dot-com bubble, the housing bubble, the 2008 meltdown, crypto hysteria, the recurring booms and busts in commodities and equities; all of these events make the same point, which is that markets do not instantly process information. Instead, they amplify errors, they overshoot, and they reflect power, psychology, manipulation and momentum as much as fundamentals.

If a theory holds only in the absence of reality, it is not a theory of the world. It is a

theory of convenience.

EMH as the intellectual foundation of deregulation

Fama's theory became the perfect justification for dismantling controls on finance. If markets are assumed to be rational, then regulation is seen as a distortion to be eliminated. If prices encode all information, then fraud is self-correcting. If bubbles do not exist, oversight is unnecessary.

From the 1980s onward, EMH provided the academic muscle behind:

- * The repeal of the Glass-Steagall Act
- * The growth of shadow banking
- * The expansion of derivatives markets
- * The ideology of “self-regulating markets”
- * And the belief that financial innovation always improves welfare.

It was the intellectual scaffolding of neoliberal finance. And it turned out to be disastrously wrong.

The 2008 crisis: a catastrophic failure of the model

The global financial crisis exposed EMH as a fantasy. Markets had not priced risk correctly. They had not incorporated obvious information. They had not recognised systemic interconnection. They had not protected investors or the public.

Instead, markets had created instruments they did not understand, mispriced the mortgages on which they were built, blindfolded themselves to the fragility of the system, and pulled the global economy into collapse. Yet Fama himself insisted that the crisis was not evidence against EMH, saying instead merely that “shocks” cannot be predicted.

When a theory explains away its own failure by redefining failure as an anomaly, it is no longer science. It is ideology.

The persistence of a failed idea

Despite repeated falsification, EMH remains embedded in:

- * Financial regulation
- * Pension-fund orthodoxy
- * Passive-fund investment design

- * Central bank assumptions
- * Macroeconomic modelling by the Treasury
- * Portfolio theory, which drives institutional investment choice
- * The teaching of economics and finance.

Why? Because the idea is useful, not descriptively, but politically.

It absolves regulators of responsibility.

It shields financiers from scrutiny.

It legitimises vast concentrations of wealth.

It sanctifies inequality as the product of merit rather than structural power.

A theory does not have to be true to endure.

It only has to serve those who benefit from its illusions.

What answering the Eugene Fama Question would require

To take the failures of EMH seriously and to rebuild financial systems that serve society rather than destabilise it would require:

- * Recognising markets as social institutions, rather than as natural phenomena, and that they are shaped by law, power, incentives, information asymmetry and manipulation.
- * Embedding regulation in the reality of human behaviour, including uncertainty, panic, herd dynamics, fraud and short-termism.
- * Reasserting public oversight because the claim that markets self-correct has been disproven at catastrophic cost.
- * Redesigning investment systems to prioritise long-term social value, not speculative churn.
- * Replacing the mythology of perfect information with the truth of radical uncertainty.
- * Building financial architecture around resilience, and not supposed efficiency, building in redundancy, buffers, and limits on leverage.

These reforms would not stifle markets. They would, however, make markets safe for everyone else, and not just for those who profit from their volatility.

Inference

The Eugene Fama Question asks why a theory that has failed so dramatically continues to frame policy so profoundly. EMH is not merely wrong; it is dangerous. It blinds societies to risk, legitimises instability, and encourages the concentration of power in institutions that repeatedly prove unable to manage their own behaviour.

To answer the question is to recognise that elegant models can be seductive precisely because they are false and that political economy must be rooted in the world as it is, not in the world financiers would prefer to imagine.

Fama taught us, unintentionally, that markets do not know best. Our task now is to build an economic and financial system that remembers it.

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