What Financial Economists Should Do

To bring a measure of validity to a treatise on the value statement of what financial economists "should" do, it is important to flesh out the subject matter realm in which financial economists operate, and the methodologies that support basic tenants of mainstream economics. The primary functions that lay the foundation for what economists do – and the subsequent branches of economics – is conducting research, collecting data, optimizing both data and efficiency, and developing intelligent and educated forecasts and theories for future events or catalysts. That is to say making decisions under the encompassing constraint of uncertainty.

Many economists – including the late James Buchanan in his paper *What Should Economists Do*, published in the Southern Economic Journal – often quote Jacob Viner for his famous quote "Economics is what economists do," a popular phrase used to either enlighten those unaware that the work that economists do is hard to explain, or provide an easy cop – out for refusing to attempt to create structure for the material economists work with.

Far be it from me to provide that economic infrastructure, a green economist halfway through an undergraduate degree, but in critiquing our predecessors we can begin to learn the importance of their work, and perhaps in taking responsibility to learn our subject matter we may move towards a shared goal in helping the field of economics to evolve, a theory that is present in James Buchanan's aforementioned work.

It is an intimidating task to attempt to take on the onus of providing a framework for what financial economists should do, but the objective becomes more reasonable from the ground up – to begin as mentioned before with what economists do, what they should do, and then advance towards what it is that financial economics do, the field in which they work, and subsequently what it is that financial economists should do.

Economics, described plainly, is the study of scarcity, how individuals optimize their consumption, the transfer of wealth, and how individuals make decisions under uncertainty. In order to complete these tasks, economists must have applicable data at their disposable, and more so have the ability to utilize that data, so as to conduct intelligent research – to reach valuable conclusions that will provide the basis for what changes need to be made to reach efficiency – perhaps within a sector of the marketplace – or discover ways to increase profits for the firm or agents.

With this logic, it becomes abundantly clear that *how* that data is collected is critical, arguably more important than the methodologies for conducting analysis on information. For any model, if the inputs are garbage, the output will be garbage. Therefore, an important tenant for what economists should do – as much for financial economists as any economic branch – is to continue to refine the way that data is collected. Currently, data is made available through several different avenues and institutions, through central banks, and intergovernmental organizations such as the United Nations, European Union, or the Organization for Economic Co-operation and Development. These are, to be assumed, very reputable organizations for data dispersion, but to advance our intellects is to question the foundation that make up our respective fields, in order to find the proverbial cracks that need to be fix.

As a corollary, if pertinent data begets the validity of an economist's work, then in an unprecedented period of technological computational advancement – the success of an economists will depend upon their ability to not only adapt to changing methods for data collection and dispersion, but their ability to master the new technological advancements that arise. At one point in time, there was most likely a doctor who would not realize he was the last doctor to ever preform a certain surgical procedure. Economic methods, not unlike procedures undergone by medical doctors, are not immune to becoming obsolete. Thus, while arguable that the proper collection of data for research is an economist's first – step, it is dually necessary that economist's remain skillful in the methodologies in which they construct their research – lest they be lost in the abyss of obsolescence.

What is particularly intriguing within differentiable economic philosophies or theories, is the use of market organization and structure as a solution or lack thereof to the economic problem. First, as quoted by James Buchanan in *What Should Economists Do*, is that "The 'market' [is] an engineered construction, a 'mechanism,' an 'analogue calculating machine,' a 'computational device,' one that processes information, accepts inputs, and transforms these into outputs which it then distributes," under the belief held that the classical "wealth of nations," logic of choice reigns supreme.

However, James Buchanan attempts to refute this logic, with the second and preceding theory – in explaining that markets are not an engineered construction, but rather the "institutional embodiment of the voluntary exchange processes that are entered into by individuals in their several capacities," an idea that corresponds well with the popular belief advanced by Friedrich Hayek that if an individual were to create the "marketplace" as we know our system for barter and exchange, it would be the greatest invention of mankind.

While convoluted, the nuance within these philosophies is important to understand the framework that economists operate, and helps to further explain that if an economist believes that the marketplace is a mechanism, the solution to the economic problem of resource allocation is computationally refined optimization within all constraints present.

If this idea is rejected, it is more worthwhile to economists to focus on the institutions in which relationships between individuals are formed, as they participate in what they believe is voluntary trade or exchange, and furthermore attempt to understand – or rather forecast – how individuals will behave to accomplish their goals, with the understanding that these goals or consumption choices will change, not bound by the limits of a constructed marketplace.

It is reasonable to assume that in either case individual behavior will more often than not follow predictable patterns of behavior, but it seems unsatisfactory an answer to declare that what economists should do is continue to study patterns of firm and individual behavior – but perhaps a little more satisfactory to declare that economists should first decide, if only for the time being, how they conceive market organization – and then concentrating on either choosing agents behavior or the components of institutions – to continue to work towards the evolution of their discipline, with the proper knowledge of their subject matter, having full disclosure of the philosophies they hold in respect to market structure, and keep a critical mind to dissonant ideas.

Having briefly discussed what it is an economist does, and the generalized philosophy of what they should do, it becomes easier to spearhead the branch of economics referred to as financial economics – and continue to discuss both what it is that financial economists do, and discuss the normative statement that there is something in particular that financial economists should do.

There are many applications of economics, and financial economics is just one of many. Within economics an individual can focus their energy into an emphasis such as agricultural, behavioral, labor, law, managerial, welfare, public, etc. These branches in any case will share ties with overarching objectives and methodologies within economics, with a generalized goal to improve conditions. The way in which an economist attempts to achieve this goal is at their own discretion. The history of financial economics, whether one believes it to be new or old, is a very interesting one. A snippet in *Pioneers of Financial Economics* written by Geoffrey Poitras and Franck Jovanovic argues that "the roots of this field stretch back to antiquity, involving the valuation of financial transactions, such as determining payment on a loan or distributing profits from a partnership," that financial economics was born the moment individuals began to barter and trade goods and services, having made decisions that will give them additional utility.

Financial economics is the study of a branch of economics that is characterized by the changing of monetary assets for monetary assets. While abstract, it is best described by focusing within two areas of concern: asset valuation, and corporate finance and structure. Financial economics is the study of the flow of capital, both to and from investors, and using this information to analyze optimal decision making and capital efficiency.

Asset valuation, as an assessment of worth, is the analysis of capital, of a company, of cash flows, and of any and all goods and services that an individual or firm is willing to exchange monetary value for. The process of asset valuation can be intrinsic, again embracing Friedrich Hayek's argument in *The Use of Knowledge in Society*, in that "if it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind." He argues that the establishment of a central planned economy will never outperform – or replace – the efficiency of an open market economy, as the behavioral nature of the market place is one of dynamic fluctuations, and chaotic movement.

No individual agent in society can utilize all information, but information can be dispersed between individuals rapidly, allowing those with comparative advantages within a moment of time to take advantage of disparity between prices. If an economist agrees with the importance of decentralization in an efficient decision making economic system, it becomes necessary for said economist to further inform what Hayek refers to as the "man on the spot," in proper decision making processes – given the information the individual has. To further improve the distinction between the individual's decision, and how it fits into the aggregate economic system.

Corporate finance, and corporate structure, is the area of finance and financial economics in which managers make decisions to increase the value of the firm, and in doing so arrive at an optimal capital structure for operations, and sources of funding for said capital structure. Financial economists working with this subject matter will focus on the applications of corporate finance, such as capital budgeting, agency choice, and the Modigliani and Miller theorems of capital structure.

As technology advances, and computational techniques evolve, the role of a financial economist should be to continue to work towards the evolution of their discipline - by keeping up to date with modern computational technology and data manipulation techniques - to be prepared to inform firms or individuals on making better optimal decisions in respect to capital efficiency and capital structure. These decisions have wide – range impacts within the marketplace, leaving an important responsibility to financial economists to know their subject matter. In taking on this responsibility, as James Buchanan believes in his work *What Should Economists Do*, economics can begin to move toward a more structured discipline.

References

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