Tomorrow's Affairs

Analysis of today
Assessment of tomorrow

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Economics is not Finance

Economics and finance are two closely related topics, yet they are not the same. What economists do is to assess the current economic situation in the light of historical facts and accordingly generate future scenarios and solutions to potential problems.

They tell you what is possible and what is ideal. They factor political and social developments into the equation, and place their focus on development rather than economic growth alone.

Financiers, on the other hand, produce “positive”, “negative” and “baseline” scenarios by evaluating past and present income statements as well as by projecting future statements.

They also take other factors into consideration, such as business valuation, profit and loss analysis, and financing needs. And they warn management about potential financial vulnerabilities based on these scenarios.

They sometimes tend to ignore that the ideal could bring success, and what is possible will not always lead to the desired outcome.

They take mathematics more seriously than economists do. In fact, most financiers have an engineering background. They are the ones who find the easiest way to help the company grow.

Although it is necessary to consider mostly economic variables along with other factors to create a growth model, political, social, cultural and corporate factors should be taken into account, and it is also necessary to devise a development model.

What looks good on paper may not become a reality

It is a fun exercise for a financier to create a model using linear methods. Economists, however, considering past events, know that such methods will not yield any accurate effects.

There is always the possibility that what looks good on paper may not become a reality when human character, climate and other risks are involved. For this reason, economists' models are written with exponential functions, instead of linear ones.

Economists do not make any variable of "zero" value unimportant by placing a ‘+’ sign between. They make the existence of each variable important with an ‘X’.

Also, single-equation methods and simultaneous equations do not apply in economics. Multiple-equation and dynamic models are used instead.

Financiers use formulas to warn management about the fact that even a profitable company can go bankrupt. And they often turn out to be right.

Economists may not know how to read financial statements as well as financiers do.

> Economists always take political and social events into consideration

Since planning is vital when designing macroeconomic models, financiers who are good at mathematics seem to succeed in economy-related positions.

Economists, on the other hand, especially those with enough life experience, always take political and social events into consideration, therefore they know from the very outset that the goals set in macroeconomic models will never be achieved.

Most financiers maintain a certain level of discipline and introversion both in their professional and personal lives compared to economists, who tend to come one step closer to a social life. They constantly observe society and politics and draw conclusions accordingly.

The life of financiers is often full of "must-have" conditions, but for economists, alternatives never run out.

Economics is very much about people

We could therefore say that economists who are committed to specific theses and do not even discuss alternatives often tend to be mathematically or financially-inclined.

Financiers use models to deal with the concept of human resources efficiency, while reluctantly accepting that the main source of employee motivation is education.

In the scenarios they create, it is always possible to achieve the desired result with a sufficient number of human capital. To them, it is just a matter of time and resources.

In fact, there might even be no need for people if businesses possess sufficient technology.

Sometimes, financiers tend to forget that economics is very much about people. Economists, on the other hand, believe that improving the quality of the labour force is crucial for productivity and efficiency, therefore they focus on the notion of development rather than on economic growth. Obviously, this does not mean that growth is unimportant.

While some economists, such as Schumpeter and Rostow, based their growth models on institutional approaches, others like Jevons, Moore and Pigou had taken exogenous factors into account, that is, influences outside the economy and conjunctural developments.

In addition to all these growth models and theories, more progressive economists chased rather ambitious ideas claiming that justice and equality could only be achieved in radical economic systems.

> Finance is a part of the grand design, but not the grand design itself

As far as finance goes, Colbert, Comptroller-General of Finances under Louis XIV, also known as the Sun King (le Roi Soleil), was an exemplary figure in history.

Throughout history, ministers of treasury and finance all around the world financed the plans of the governments, including wars which require tremendous amounts of money, designed and implemented ways out of challenging situations, whilst all the time trying not to endanger the welfare of citizens.

Finance is a part of the grand design, but not the grand design itself. Therefore, using a financier's approach might lead to giving up on everything or undertaking daring missions.

Finance is important in terms of helping meet economic or political objectives, but so are parameters such as priorities, savings, effectiveness, efficiency, education, diplomacy, culture and public healthcare.

"How many facilities are needed?" should be the first question of a government determined to have their citizens exercise or play sport, not "How much money do we have?" First, the need is determined then the financing is provided.

Language of philosophy vs language of mathematics

Finance has become a rising star since in the last two decades as governments, businesses and individuals accumulated debt that exceeded their income. High levels of debt cannot be rationalised even by conventional economic theories, whilst economics has moved closer to mathematical formulas and lost its philosophical approach.

According to the principle of finance, “growth must be at X level so that debts can be repaid wherever it is economic to do so”.

Economics, on the other hand, cautions that "with this average rate of growth, borrowing rates should not exceed X level”.

Finance says whatever can be used should be used whenever it is technically possible, while economists say that some practices that are deployed when it is technically convenient might lead to political and social problems.

Economists use the language of moral philosophy rather than the language of mathematics - Emre Alkin

As mentioned above, a significant number of financiers have engineering or mathematics backgrounds, hence they believe that every equation they use and every model they design works flawlessly.

But they tend to forget - or perhaps they do not even know - that Adam Smith was actually a philosopher even though he was considered the father of modern economics and he regarded human beings as the agents of knowledge, morality, and economics.

This is why economists use the language of moral philosophy rather than the language of mathematics, which makes economics a normative science as well as a positive science.

Obviously, not everyone who holds an economics degree is an economist. True economists have to have knowledge about multiple disciplines, including finance, statistics, business administration and accounting, and have more than a mere interest in interdisciplinary subjects such as psychology, history, mathematics and politics.

Only this mosaic of knowledge and understanding would enable them to offer suggestions, even solutions, to growth, development, and welfare-related problems.

Life-savers

Which brings me to my central point: It would be more advisable to appoint from inside the organisation to managerial positions in central banks and other regulatory authorities.

In light of this advice, well-trained human resources are a must-have as they would be life-savers when it comes to helping prevent or repair the damages caused by people appointed to top positions in the organisation despite the fact that they have no prior experience or knowledge about the culture and history of the organisation in question.

> People who are expected to make decisions that will impact people’s lives must have extensive life experience

People who are expected to make decisions that will impact people’s lives must have extensive life experience, must not care about being popular, and most importantly, they must be in a state of wellbeing and function well in the world, and also have sufficient empathy skills.

So far, we have seen that appointing people with political, private sector or academic backgrounds to government or regulatory positions, which is a quite common practice in developing countries, have never yielded positive consequences, and the unusual attitudes and behaviour of these appointees have often caused the organisations they work for to lose reputation.

And this fact might be one of the reasons why some countries fail to develop.