Nobel Toast

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Your Majesties, Your Royal Highnesses, Your Excellencies, Honored Laureates, Ladies and Gentlemen

Let me begin by thanking the committee for granting this year's prize in Economic Sciences to me, my colleague Lars Peter Hansen, and Robert Shiller.

I have learned much over the years from Lars's work and from listening to his penetrating comments on the work of others in the University of Chicago's many research workshops. I have also learned a great deal from Bob's writings and from his presentations at Chicago over the years. Bob and I agree on many things in finance, we disagree on others, but always cordially and with an eye toward learning more from someone with a different viewpoint.

Important to me personally is the recognition the Prize gives to the standing of finance in economics. When I started in the early 1960s, finance as a serious research area was just getting started. We had Harry Markowitz' magnificent Chicago Ph.D. thesis on portfolio theory, and we had the theorems of Merton Miller and Franco Modigliani on the irrelevance of the financing decisions of firms. Spurred by the coming of computers, empirical research on what became the theory of efficient markets was getting underway. That was it in terms of major paradigms, there were no good research journals in finance, and almost all the serious action in finance was at two places, Chicago and MIT.

Research in finance exploded over the next 20 years. William Sharpe, John Lintner, Robert Merton, Robert Lucas, Douglas Breeden, and others developed our major asset pricing models – prescriptions about how risk should be measured and the relation between risk and expected return. Fischer Black, Myron Scholes and Robert Merton developed the first rigorous options pricing model. Equally important, an army of excellent young empirical researchers (Lars and Bob are among the best) entered finance, and all the major theoretical paradigms were put through the empirical wringer many times.

Today, research in finance continues its impressive growth. Most major universities have first rate research faculties in finance. There are now at least five excellent research journals in finance and there are others that are better than anything we had in the 60s. The major paradigms of finance are familiar to Ph.D. students in other areas of economics, and (due to the work of people like Lars and Bob) finance now has a major role in macroeconomics.

In my view, after 50+ years of vertiginous growth, finance is now comfortably first among the areas of economics in which there is a rich interplay between theory, empirical tests, and the development of models to accommodate the challenges raised by evidence.

In the applied domain, finance is far and away the most successful area of economics in terms of penetration of theory and evidence into real world applications. The expansion of the finance industry over the last 50 years parallels the development of academic research in finance and has borrowed heavily from it.

Research in finance has been and continues to be a great ride. It has been incredibly satisfying to participate in the growth of finance and to know and learn from all the old giants who created the field and the new giants (like Lars and Bob) who continue to push its boundaries.