

Professor Eugene F. Fama, Economist and Professor at the University of Chicago
1960 Tufts Graduate
Recipient of an Honorary Degree at the Tufts University 150th Commencement -
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Fama's Contribution to the Economics Profession, by Marcelo Bianconi (Associate Professor of Economics, Tufts University), posted on March 5, 2002

Prof. Fama has made important contributions to economics in several subfields of the discipline and is a pioneer in the development of finance as a discipline and as a subfield of economics. In general, his main area of research has been at the intersection of economics, business and finance. He has studied the behavior of prices of financial securities and its relationship with portfolio allocation by individuals and businesses, as well as the information structure of capital markets, firms and competition, risk management, inflation and economic activity, prices of different currencies, and money and banking. Prof. Fama's work has been marked by a lucid blend of well defined theoretical and abstract questions with the concrete investigation of these questions by empirical methods based on statistical and econometric analysis with real world data.

In 1970, Prof. Fama published an influential and classic survey entitled "Efficient Capital Markets: A Review of Theory and Empirical Work" in the most prestigious professional finance journal, *The Journal of Finance*. As the title implies, the article focuses on the theory and empirical evidence of efficient capital markets: the very idea that interactions among market participants and the frictionless dissemination of information prevent individuals from making assured gains in competitive capital markets. Some of the main features of the survey were based on Prof. Fama's own research, including his classic 1965 article in the *Journal of Business* entitled "The Behavior of Stock Market Prices" in which he presents compelling statistical evidence based on the random walk model of price behavior ratifying the efficient market hypothesis. This work inspired and was followed by an immense literature on the validity of the efficient market hypothesis and the root causes of its potential failure in all areas where competitive trading of assets takes place. Twenty one years later, in 1991, Prof. Fama published a sequel to his article in the Fiftieth Anniversary issue of *The Journal of Finance*, where he evaluates the literature following his survey as well as his own related work.

In the 1970s, Prof. Fama wrote two books that perpetually shaped the field of finance as a discipline on its own. *The Theory of Finance*, co-authored with Nobel Prize winner Prof. Merton Miller also of the University of Chicago in 1972, and his own *Foundations of Finance*, in 1976, became the milestones of the finance discipline across universities worldwide. Economics departments ever since have included finance as an integral part of their curriculum based on the natural overlap with the more traditional subfields such as macroeconomics, microeconomics, and econometrics. Prof. Fama himself has worked actively in integrating modern finance with the more traditional subfields of the economics discipline. His 1980 article "Banking in the Theory of Finance", in the prestigious *Journal of Monetary Economics*, presents a classic union of traditional money and banking concepts widely used in the economics discipline with the modern finance concepts of security pricing and risk taking in financial markets.

Another fertile and inspiring area of research of Prof. Fama has been the application of finance concepts and methodology to the study of foreign exchange markets. His 1984 article in the *Journal of Monetary Economics* entitled "Forward and Spot Exchange Rates" has become a benchmark in a vast literature that aims to empirically identify the existence and dynamic characteristics of risk premia in foreign exchange markets. The tests carried out by Prof. Fama in this article, known in the professional circles as the 'Fama tests', have become a source of inspiration for academics, graduate and undergraduate students, and professionals across the international economics, business and finance areas, and are a potential part of the curriculum of applied econometrics and financial econometrics courses worldwide.

In the late 1980s and early 1990s, Prof. Fama has made several important contributions in the area of predictability of stock returns and its relationship to economic activity as a whole. In particular, in a series of articles co-authored with Prof. Kenneth French of MIT, he has examined whether several alternative financial data may improve the predictability of stock returns and economic activity. His work examines data at the macroeconomic level, such as interest rates and treasury bonds yields at different maturity horizons, and at the firm level such as dividend yields, and their relationship to stock returns and business fluctuations. An article in this series entitled "The Cross Section of Stock Returns" awarded Profs. Fama and French the Smith-Breeden Prize for the best paper in *The Journal of Finance* in 1992.

Over the last 33 years, Prof. Fama has been prolific in other areas of economics as well. He has made a mark in the microeconomic theory of the firm introducing agency and incentives problems in his *Journal of Political Economy*, 1980, article entitled "Agency Problems and The Theory of The Firm." In articles co-authored with Prof. Michael Jensen of Harvard Business School in the early 1980s, he has examined issues of law and economics relating to ownership and control of firms, residual claims of profits, and alternative organizational structures. These include "Separation of Ownership and Control" and "Agency Problems and Residual Claims" both of which appeared in the *Journal of Law and Economics* in 1983. In 1991, he published an article in the *Journal of Labor Economics* on incentive payoffs in labor contracts in the labor economics subfield of the economics discipline entitled "Time, Salary, and Incentive Payoffs in Labor Contracts."

To sum, the economics profession has largely benefited from Prof. Fama's contributions to the development of finance as a discipline and his legacy will remain an inspiration for current and future generations of academics, students and professionals.