



Eugene F. Fama

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[LINK TO ABSTRACT](#)

Eugene Fama, a third generation Italian-American, was born in Massachusetts and raised in a suburb of Boston to a working class family. He attended a Catholic high school before entering Tufts University in 1956, where he won honors in athletics and Romance languages (Schwert 2015). At Tufts he discovered economics. He proceeded in 1960 to study at the Graduate School of Business at the University of Chicago, where his Ph.D. advisors would be Merton Miller and Harry Roberts.

In 2013 Fama shared the Nobel Prize in Economics with Lars Peter Hansen and Robert Shiller for their “empirical analysis of asset prices.” Fama’s contributions are in the study of capital market efficiency, asset pricing models, the behavior of interest rates, exchange rates, futures prices, and inflation rates, as well as agency problems, capital structure, and banking (for overviews of Fama’s research see Fama 2011; Schwert 2015; Cochrane 2013; Henderson 2013). Fama is associated with extreme skepticism about beating the market or operationalizing the idea of a bubble, but many of his papers lie elsewhere, and with astounding citation counts.² In his long career at Chicago, he has advised more than 100 students (Schwert and Stulz 2017). A warm and inspiring description of Fama as advisor and colleague is provided by John Cochrane and Toby Moskowitz (2017).

1. George Mason University, Fairfax, VA 22030. I thank Ryan Daza and Andrew Humphries for assistance.

2. The Google Scholar page for Fama shows 257,486 citations (September 24, 2018). That for Friedrich Hayek shows 112,126, and that for Ronald Coase 100,767, so Fama has more than those two combined, although perhaps about 60 percent of Fama’s most-cited works are coauthored with one other author. Still, even after discounting for coauthorship, Fama’s tally markedly exceeds that of either Hayek or Coase. Fama’s ten most-cited papers are: Fama and Jensen 1983a; Fama 1970; Fama and French 1992; Fama 1965 (which is his dissertation work); Fama and MacBeth 1973; Fama and French 1993; Fama 1980; Fama 1991; Fama and French 1996; Fama and Jensen 1983b. His most-cited book is Fama 1976.

Cochrane and Moskowitz (2017, 813) report that every day, even Saturday and Sunday, Fama arrives to his University of Chicago office at 8 a.m. Fama has described his routine: “I work every day, but I never work a full day. I get up at five o’clock in the morning and I work basically all morning until maybe one o’clock, two o’clock, and then I go play golf. I go windsurfing. I play tennis. And that’s it” (Fama 2007, 22).

In early 2018, I sent Professor Fama EJW’s questionnaire about ideological character and migration,³ and he graciously replied:

1. When you were growing up, what sort of political or ideological views were present in your family and household? Did you have views as a youngster, say at age 18? If so, kindly describe them for us.

Hardcore Democrat and JFK admirer.

2. How about at age 25 or so? Had they changed at all by then?

Well on the way to being a libertarian.

3. And how about age 35 or 40? Please describe any changes undergone since your early twenties.

Hardcore libertarian.

4. And now please bring it down to the present. Have your views changed since your late thirties? How so? How would you describe your present political sensibilities or outlook?

Haven’t changed.

5. Overall, would you say your views have changed, and, if so, have they changed in a way that can be summarized as changes of a particular nature or character? Did your thinking “move” in a particular “direction” (using the notion of ideological space)?

Seeing Government as the problem, not the solution.

6. If your views did undergo changes, what caused the changes? Was it reading, thinking, experience of some kind, or the influence of particular people, including intellectual figures? All of the above? Something else? We will be very grateful if you try to explain why your views changed, to whatever extent they did.

Observing the failure of well-intentioned Government policies and programs, with Johnson’s “Great Society” at the forefront. (Fama 2018)

Fama has on a number of occasions freely described himself as “libertarian.” It seems clear that his libertarianism is of the practical, down-to-earth sort—Milton Friedman combined with Armen Alchian—as opposed to the more philosophical sort drawn from reading moral or political theory. The famous *Journal of Law and Economics* papers by Fama and Michael Jensen on ownership, risk-bearing, residual

3. Previous laureates’ responses to the questionnaire are collected in EJW 2013.

claimancy, monitoring, and agency characterize the private-sector organization as a nexus of voluntary contracts, competing against other organizations by correcting its internal functioning and initiating improvements (Fama and Jensen 1983a; b; see also Fama 1980). Specialization often recommends functional separation, for example between those who initiate and implement decisions, those who ratify and monitor those decisions, and those who bear risks. Organizations that most profitably handle such problems will tend to be selected for within a free-enterprise system. At the start of each paper, Fama and Jensen (1983a; b) note that the work stems from a single earlier manuscript titled “The Survival of Organizations.” Neither paper contains any mathematics.

In his responses to the questionnaire, Fama (2018) indicates a Democratic upbringing and youth, and he cites “observing the failure” of “Great Society” programs as influential to the formation of his libertarian views; those programs commenced in 1964 and 1965. Fama was 26 years old in 1965, and presumably “failure” was not observed immediately, so it would seem that he was still evolving into at least his late twenties. But he also reports that by age 25 he was “well on the way to being a libertarian,” so it seems that his first really mature viewpoint (by age 30, say) was one that evolved pretty directly toward his later libertarian outlook. In terms of the ideological migration categories used to classify the laureates in the present research project (Klein 2013, 219), Fama could perhaps be placed in the “a bit more” category of those migrating in the classical liberal direction during his or her mature years—indeed, we have seen that a number of the Chicago classical-liberal economists firmed up in that way throughout the 1960s and 1970s.

Fama differs from several other famous free-market Chicago economists in that he has not much addressed popular audiences, and on such occasions he has stuck close to his research expertise, particularly during and right after the 2008 crisis, especially in panel discussions and interviews. He has published only very few popular articles or op-eds, no popular books, and he has participated little in organizations with political or ideological purpose. But in his public appearances he is, albeit reserved, affably open about his libertarian outlook in politics. And he has lent his name to several petitions:

1. 2001 (Milton Friedman), opposing the estate tax ([link](#))
2. 2006 (Independent Institute), favoring immigration liberalization⁴
3. 2007 (Club for Growth), opposing protectionism
4. 2007 (National Taxpayers Union), opposing “windfall” taxation
5. 2009 (Cato Institute), opposing the Federal Recovery Act
6. 2009 (Atlas Foundation), opposing “green” protectionism

4. Petitions 2 through 7 are covered by Hedengren et al. (2010, 317), linking to data and petition text.

7. 2009 (Wall Street Journal), favoring Federal Reserve Bank independence
8. 2012, supporting Mitt Romney for President ([link](#))
9. 2013 (Larry Kotlikoff), supporting the Intergenerational Financial Obligations Reform Act ([link](#))
10. 2016, opposing Hillary Clinton for President ([link](#))

In 2006 Fama and Kenneth French published an op-ed in the *Wall Street Journal* calling for a tax-code change to make it that holders of ordinary mutual funds (as opposed to exchange traded funds, or ETFs) would face capital gains taxes only when redeeming shares of the ordinary mutual fund—a convenience that ETFs achieve by virtue of their doing untaxed exchanges in kind, which are not possible for ordinary mutual funds. The proposed reform would “level the playing field for ETFs and ordinary funds” (Fama and French 2006). Meanwhile, since the op-ed, no reform has been made.

During the financial crisis and recession, journalists and others turned to Fama, and he answered the call. I draw on material appearing 2009 to 2013, quoting at length.

Robert Litterman conducted an interview with Fama in 2012:

Litterman: What do you think caused the global financial crisis?

Fama: I think the global crisis was first a problem of political pressure to encourage the financing of subprime mortgages. Then, a huge recession came along and the house of cards came tumbling down. It’s hard to believe that without a pretty significant recession, the financial system would have come crashing down like it did. Subprime was basically a U.S. phenomenon, yet the crisis spread around the world. Financial institutions in other countries were certainly holding subprime debt, but in the past, financial institutions have gone bust because they made dumb decisions without triggering widespread crisis. I don’t think the crisis was a problem with markets. The big recession was the trigger. The worst thing to come out of that experience, in my view, is the concept of “too big to fail.”

Litterman: I totally agree. Can you elaborate on that?

Fama: Basically, the institutions that are considered to be too big to fail have their debt priced as if it’s riskless, which gives them a low cost of capital and makes it very easy for them to expand and become an even bigger problem. Plus, everybody now accepts the assertion that they are too big to fail, which creates a terrible moral hazard for the management of these financial institutions. Business leaders won’t consciously tank their companies, but too big to fail will push them toward taking more risk, whether they realize it or not. I don’t think Dodd-Frank (the Dodd-Frank Wall Street Reform and Consumer Protection Act) cures that moral hazard problem. Even if law-

makers could devise the perfect regulation for such a cure, the chance that it will be implemented by the regulators in the way designed is pretty close to zero. The simplest solution would be to raise the capital requirements of banks. A nice place to start would be a 25% equity capital ratio, and if that doesn't work, raise it more. The equity capital ratio needs to be high enough that a too-big-to-fail financial institution's debt is riskless, not because of what is essentially a government guarantee but because the equity ratio is very high. (Fama and Litterman 2012, 16)

The following comes from an interview of Fama by Jeff Sommer, appearing in the *New York Times* in 2013:

Sommer: Now let me ask you, have you ever testified before Congress or given policy advice to political figures?

Fama: No, I'm too unpredictable. I don't give advice like that. I don't believe anyone wants to hear what I have to say.

Sommer: Why's that?

Fama: Well, I'm an extreme libertarian, but I realize we're in a democracy, and in a democracy people can have views of all stripes and there's no reason to argue about it.

Sommer: Well, you're a Nobel laureate now and people are curious about your views. For example, whenever we talk you always seem to be re-reading "The Road to Serfdom," by Friedrich Hayek. That's an important book for you, isn't it?

Fama: Yes, it's a great book. It's a philosophy, of course; it's not empirical. What Hayek is basically saying is that to the extent you let government take over economic activity you're basically giving up freedom, and I think that's a point Milton Friedman made quite emphatically throughout his lifetime.

I consider myself closer to Milton in my thinking than to anybody else. And Milton was also an enthusiastic libertarian.

Sommer: Do you accept the basic teachings of John Maynard Keynes, which tell us that government should spend more to counter the effects of a recession?

Fama: No, I don't think there's a lot of empirical evidence that Keynesian spending really helps.

Sommer: Despite his advocacy of smaller government, Hayek believed in a social safety net. Do you?

Fama: Yes, he did, and I have a similar view. I think we need Social Security, things like that. ...

Sommer: Do you believe in financial regulation?

Fama: Of course, some regulation, yes. You need a level playing field, you need the government to step in sometimes. But I think we've gone too far with Dodd-Frank.

Sommer: In the financial crisis, do you think the government should have bailed out the big banks?

Fama: No, I don't. I would've favored nationalizing the banks, not bailing them out.

Sommer: Really? That's not very libertarian, is it?

Fama: Well, we're talking about realistic alternatives. It's not credible that in a financial crisis, the government will do nothing. It never has. There are going to be demands for it to do something. So you've got two choices now. Nationalize them or bail them out. Bailing them out gives them terrible disincentives; it encourages them to take risks because they'll be bailed out. So I'd nationalize them—and clean them up and then reprivatize them.

Sommer: So would you have favored that the government do nothing at all?

Fama: I said at the time that it would be an interesting experiment. But what people argue is that it would be quite destructive, that it would create long-term problems. We don't know that that's true, but I think it's kind of moot because it's not an experiment that's ever going to be run. (Fama 2013)

In April 2009 Fama participated in a lengthy panel discussion at the University of Chicago that was recorded by C-SPAN. Fama's remarks throughout are steadily libertarian, though often moderate and pragmatic. Here are some of his spoken remarks, transcribed:

I would prefer that the government stays out of the way and lets failed firms fail. ... What happens is that the FDIC in principle comes in and draws a line on the liabilities side of the balance sheet and says everything below the line is gone. And now we can go out and raise some new equity capital and start the bank over again. What we're seeing at the moment is: for whatever reason the FDIC has applied this power in a somewhat random way. So Wachovia got shut down. Washington Mutual got shut down. IndyMac got shut down. Countrywide got shut down. These are really big banks. They were not... Under the current bad terminology they would be termed too big to fail, but they were allowed to fail. It wasn't a big deal. Once you knock out the debt overhang problem, once you get rid of the low-value debt, it turns out there are lots of people that want the deposits of these banks. It's a cheap way of expanding your deposits. There's nothing like deposits as a way of financing your activities. In all of these cases, these firms were simply reorganized and taken...either sold off in pieces or taken in entirely by other banks. Now, this is kind of seamless because a bank is nothing but an accounting system. That's all it is. And you can merge these accounting systems pretty easily. Even your account number doesn't change when your bank gets acquired by another bank. Everything stays the same. It's all just accounting. So I would really prefer—and I think going forward the sector would be much more efficient if—we simply let failed firms fail. (Fama 2009, 11:20–13:35)

Citibank would have been a great company to shut down. Everything in Citibank is profitable except for its trading desk and its proprietary portfolio. This is true of all of these institutions by the way. All of these investment banks were incredibly profitable until they became corporations. When they became corporations what happened was they could raise capital from the outside public. This would allow them to get into proprietary trading and proprietary asset holdings that they had never done before. So all of their classic investment banking activities were and remain profitable. It's their trading desks and their proprietary portfolios that brought them all down. So I think that was a big mistake on their part. It ultimately killed them, but be that as it may, we're kind of stuck with it. I think the current bailout mentality really is a disaster for the country, not just for the financial industry. The moral hazards that are sitting in the background that are created by a bailout mentality are just horrendous because basically now you're playing with other people's money and that's not the way markets are supposed to work. (Fama 2009, 14:55–16:15)

What typically happens in a recession is that uncertainty goes way up. And the more severe the recession, the more uncertainty goes up. So if you look back at all the previous recessions, what you'll see is that asset returns become much more variable around recessions. And we've observed that with this one as well. Now the last thing you want the government to do in that circumstance is to kick variance into the process. You don't want them to do that. You don't want them to do things that *increase* uncertainty. But that's precisely what the government's been doing. It bounces back and forth between policies, can't quite decide what it wants to do. So what do people do rationally in that circumstance? They step back and wait... I think we should have a moratorium on government action. What happens if the legislature doesn't meet for a year? Are we better off or worse off at the end? So an example is the state of Texas. The legislature only meets every other year, and they don't seem to be in such a terrible state. They have no income tax. They're well-funded. They're not having the same problems as other states. But basically I think the problem with government intervention is that each politician has a short horizon, and they're very risk-averse, and they don't want to be accused of doing nothing in the face of what looks like a crisis. So they tend to do things that make things worse. Everybody adores Franklin Roosevelt, but it's really easy to make a strong case that the Depression wouldn't have lasted so long if he hadn't been so intrusive. (Fama 2009, 16:45–18:55)

Perhaps the single best interview was that with John Cassidy appearing in the *New Yorker* in 2010. Here are some highlights:

Cassidy: Is it not true that in the credit markets people were getting loans, especially home loans, which they shouldn't have been getting?

Fama: That was government policy; that was not a failure of the market. The government decided that it wanted to expand home ownership. Fannie Mae and Freddie Mac were instructed to buy lower-grade mortgages.

Cassidy: But Fannie and Freddie's purchases of subprime mortgages were pretty small compared to the market as a whole, perhaps twenty or thirty per cent.

Fama: (laughs) Well, what does it take? . . .

Cassidy: Some people might say one of the big lessons of the crisis is that the Modigliani-Miller theory doesn't hold. In this case, the way that things were financed did matter. People and firms had too much debt.

Fama: Well, in the Modigliani-Miller world there are zero transaction costs. But big bankruptcies have big transaction costs, whereas if you've got a less levered capital structure you don't go into bankruptcy. Leverage is a problem. . .

The experiment we never ran is: Suppose the government stepped aside and let these institutions fail. How long would it have taken to have unscrambled everything and figured everything out? My guess is that we are talking a week or two. But the problems that were generated by the government stepping in—those are going to be with us for the foreseeable future. Now, maybe it would have been horrendous if the government didn't step in, but we'll never know. I think we could have figured it out in a week or two.

Cassidy: So you would have just let them. . .

Fama: Let them all fail. (laughs) We let Lehman fail. We let Washington Mutual fail. These were big financial institutions. Some we didn't let fail. To me, it looks like there was not much rhyme or reason to it.

Cassidy: What about Ben Bernanke and Hank Paulson's argument that if they hadn't taken action to save the banks the whole financial system would have come crashing down?

Fama: Maybe it would have—for a week or two. But it pretty much stopped for a week or two anyway. The credit markets stopped for more than a week or two. But I think that was really a function of increased uncertainty about the future.

Cassidy: Did you think this at the time—that the government should let the banks fail?

Fama: Yeah—let 'em, let 'em. Because the failures of, like, Washington Mutual and Wachovia—other banks came swooping in to pick up their deposits and their other good assets. Of, course, they didn't want their bad assets, but that's the nature of bankruptcy. The activities that these banks were engaged in would have continued.

Cassidy: Why do you think the government didn't just step back and let it happen? Was the government in hock to Wall Street, as many have claimed?

Fama: No. I think the government, Bernanke. . . Bob Lucas, I shouldn't quote Bob Lucas, but what he says is "not on my watch." That, basically, there is just a high degree of risk aversion on the part of people currently in

government. They don't want to be blamed for bad outcomes, so they are willing to do bad things to avoid them. I think Bernanke has been the best of the performers. ...

Cassidy: What is your view on regulating Wall Street? Do we need more of it?

Fama: I think it is inevitable, if you accept the view that the government will bail out the biggest firms if they get into trouble. But I don't think it will work. Private companies are very good at inventing ways around the regulations. They will find ways to do things that are in the letter of the regulations but not in the spirit. You are not going to be able to attract the best people to be regulators.

Cassidy: That sounds like an old-fashioned Chicago argument—skepticism about regulation.

Fama: Yes. We have Ragu (Rajan), Doug Diamond—they are as good banking people as there are in the world. I have been listening to them for six months, and I would not trust them to write the regulations. In the end, there is so much uncertainty, and so much depends on how people will react to certain things that nobody knows what good regulation would be at this point. That is what is scary about government bailouts of big institutions.

Cassidy: So what should we do? If the President called you tomorrow and said, "Gene, I don't think our way is working. What should we do?" How would you respond?

Fama: I don't know if these are even the big issues of the time. I think that what is going on in health care could end up being more important. I don't think we are going down the right road there. Insurance is not the solution: it's the problem. Making the problem more widespread is not going to solve it.

When all this (the financial crisis) started, I joined the debate. Then I stepped back and said, I'm really not comfortable with my insights into what the best way of proceeding is. Let me sit back and listen to people. So I listened to all the experts, local and otherwise. After a while, I came to the conclusion that I don't know what the best thing to do is, and I don't think they do either. (laughs) I don't think there is a good prescription. So I went back and started doing my own research.

Cassidy: Couldn't we just ban further bailouts, passing a constitutional amendment if necessary? That would be in line with your views, wouldn't it?

Fama: Right, but is that credible? It's very difficult to explain how A.I.G. issued all the credit default swaps it issued if people didn't think the government was going to step in and bail them out. Government pledges, in any case, have little credibility. ...

Cassidy: Do you and Dick Thaler discuss this stuff when you are playing golf?

Fama: Sure. We don't want to discuss his golf game, that's for sure. (Fama 2010)

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