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Harry M. Markowitz [Ideological Profiles of the Economics Laureates]

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Abstract

Harry M. Markowitz is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called “The Ideological Migration of the Economics Laureates,” which fills the [September 2013 issue of *Econ Journal Watch*](#).

Keywords

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

JEL classification

A11, A13, B2, B3

Link to this document

http://econjwatch.org/file_download/743/MarkowitzIPEL.pdf

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Harry M. Markowitz

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Harry Markowitz (1927–) was born and raised in Chicago, where his parents owned a grocery. Markowitz says they lived in a “nice apartment” and he “never was aware of the Great Depression” (Markowitz 1991b).

Markowitz says his philosophical “trains of thought” began in high school while reading books like Darwin’s *Origin of Species*. He commented: “I was especially fascinated with how Darwin marshalled his facts, argued his case and considered possible objections.” He subsequently read books on physics, astronomy, and philosophy “from wonderful big, old, musty used book stores then in downtown Chicago.” Markowitz considered David Hume to be “his” philosopher, one who he says “impressed me the most” (Markowitz 1993, 3).

He went to the University of Chicago for undergraduate and graduate school, and, interested in questions about utility, he was drawn to economics. His dissertation was about finding solutions on “how to compute efficient sets for large numbers of securities, and how to incorporate mean-variance analysis into the theory of rational behavior under uncertainty.” Markowitz recalled Milton Friedman saying, “I’ve read your dissertation and can’t find any mistakes in it. There is just one problem: this is not a dissertation in economics. We cannot award you a Ph.D. in economics for a dissertation that is not economics.” Markowitz did earn his doctorate that day (Markowitz 1991a/1959, 382).

At Chicago, Markowitz became involved with the Cowles Commission, and at Jacob Marschak’s suggestion, worked on applying mathematics to the stock market (Markowitz 2013). Markowitz joined the RAND Corporation in 1952. He then became professor at Baruch College in New York before joining the University of California at San Diego.

IDEOLOGICAL PROFILES OF THE ECONOMICS LAUREATES

Markowitz's famous portfolio theory, first published in 1952, would earn him the Nobel Prize in 1990. The theory shows that risk is related to covariance as well as variance. Varian explains: "if a portfolio is highly diversified, so that the amount invested in any given asset is 'small,' and the returns on the stocks are highly correlated, then most of the marginal risk from increasing the fraction of a given asset in a portfolio is due to this covariance effect" (Varian 1993, 161).

In 1993 Markowitz expressed his own countenance toward aspirations of contributing to the social good:

Some economists report that they entered economics to better mankind's state (e.g., see Szenberg [1993]). I have never thought it in my power to much improve the human condition generally. Much of human ill is due to violent aggression, political suppression, ancient hatreds and the like. These are not matters I know how to deal with, either from my training as an economist not with the decision making techniques I have developed. Together with my wife, I try to be a good neighbor, contribute moderately to charity, try to help my children, grandchildren, students and colleagues when I can be of service, and the like. That done, I feel that I have paid my dues and may indulge myself in life's pleasures, including the struggle with interesting problems and questions of philosophy. (Markowitz 1993, 8)

Although Markowitz does not appear to have written openly about his ideological beliefs, he has commented on the recent recession. Bailouts, he says, will not fix the underlying problems: "What good is supervision, for example, if supervisors have no more idea than anyone else of the value of supposedly 700 billion dollars worth of pieces of paper?" (Markowitz 2008). Over time, however, he believes the market will recover once information about bad risk-taking becomes available. Applying his own portfolio theory, Markowitz points out what he sees as the origin of the crisis: "Diversifying sufficiently among uncorrelated risks can reduce portfolio risk toward zero... [b]ut financial engineers should know that's not true of a portfolio of correlated risks" (Crovitz 2008). To avoid such crises, Markowitz says: "If the choice is requiring mortgages for people who don't qualify or keeping the banking system sound, we should learn to opt for sound banking every time" (ibid.).

In a 2008 piece titled "What to Do About the Financial Transparency Crisis," Markowitz outlines a "proposal for gaining insight into these instruments," a proposal apparently to be carried out by a government agency or under government supervision (Markowitz 2008). It involved four parts: (1) a census of the makeup, rules, and ownership of financial instruments, (2) calculation of

the exposure of the instruments, (3) categorization of the exposures, and (4) dissemination of the information on a “need-to-know basis” to private decision-makers and analysts. He elaborates on the first part, the census itself:

With respect to Point (1), the size of the proposed survey is not large as compared to government efforts such as the Census Bureau’s Annual Survey of Manufactures (ASM). The motivation for responding to the proposed survey can include whatever motivates the respondents to the ASM, plus the additional motivation that if you don’t respond we (the government) will assume that your paper is worthless, evaluate your firm on that basis and maybe shut you down. (Markowitz 2008)

Regarding making information from the project available on a need-to-know basis, he adds:

As to Point (4), clearly stockholders, counterparties, regulators and invited merger partners have a right as well as need to know risk exposures of a firm. Academicians perhaps can do with aggregates, or use databases confidentially, and may contribute to an understanding of how not to get into this mess again. (Markowitz 2008)

In a 2009 paper, he continued:

First and foremost, Congress should instruct Fannie Mae that the safety of the banking system must take priority over the objective of providing housing for low-income families. Second, the government should sponsor a survey of direct exposures and an analysis of indirect exposures of obscure financial instruments. This action is necessary to help restore clarity and trust to the financial system. Third, regulators should recognize that credit default swaps are insurance against correlated risks and are thus subject to much greater *portfolio* risk than is a portfolio of uncorrelated risks.

In general, businesses should understand that financially engineered products are based on assumptions regarding not only parameter estimates but also model specification (model risk). With a highly leveraged portfolio of marked-to-market products, such a misspecification can have disastrous consequences. (Markowitz 2009, 27)

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Eric S. Maskin

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Eric Maskin (1950–) grew up in New Jersey, and in high school he found an affinity for mathematics. He attended Harvard University and earned a bachelor's degree in math. During his undergraduate education he happened upon Kenneth Arrow's class on information economics, "which was so inspiring that I decided to change direction. It seemed to me that economics combined the best of both worlds: the rigor of mathematics with the immediate relevance of a social science" (Maskin 2013a). He continued at Harvard for his master's and Ph.D. in applied mathematics, but focused on economics. Under Arrow's direction, Maskin wrote his dissertation on mechanism design and social welfare (Maskin 2008). As in his dissertation, Maskin's early work focused on mechanism design implications for social choice. Later he worked on auctions, monopoly, and game theory, specifically discontinuous games (Cowen 2007).