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Myron S. Scholes [Ideological Profiles of the Economics Laureates]

Daniel B. Klein, Ryan Daza, and Hannah Mead

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Abstract

Myron S. Scholes 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

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Myron S. Scholes

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

Myron Scholes (1941–) was born and raised in Ontario. His father, born in New York City, was a teacher in Rochester. He moved to Ontario to practice dentistry in 1930. Scholes’s mother moved as a young girl to Ontario from Russia and its pogroms (Scholes 2009a, 235). His mother and his uncle ran a successful chain of department stores. Scholes’s “first exposure to agency and contracting problems” was a family dispute that left his mother out of much of the business (Scholes 2009a, 235). In high school, he “enjoyed puzzles and financial issues,” succeeded in mathematics, physics, and biology, and subsequently was solicited to enter an engineering program by McMaster University (Scholes 2009a, 236–237). Scholes credits his mother with making him “become interested in economics and, in particular, finance” (Scholes 2009a, 237).

About his deciding whether to become a physicist or an economist, Scholes reflected:

While working for my uncle’s firm, I designed a puzzle for a magazine sold to teenage girls. I worked on this puzzle for weeks to make it interesting but difficult. When I presented it to the board and editorial committee of the magazine, no one understood what I had done. I decided then and there that I really enjoy working with people, being involved in activities that were direct and not too abstract, removed or singular. I came to realize that I loved creating with others and working on problems that had real-world application. For me, the most rewarding activities have always been conceptualizing difficult problems and then immersing myself in the details to test my theories. (Scholes 2009a, 238)

Scholes went to McMaster for his undergraduate studies in economics and liberal arts. He recounted:

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McMaster turned out to be a fortuitous choice. Because it was such a small school, Professor McIver, a University of Chicago graduate in economics, worked closely with me in my studies. He directed me to read and understand the works of many classical economists, including the more contemporary teachings of Milton Friedman and George Stigler, two subsequent Nobel Prize winners in economics. I was impressed with their writings. (Scholes 2009a, 238)

Upon graduation, Scholes decided to enter business school, because of his fondness of economics and his decision to enter into his uncle's family business. In considering graduate school, he knew where he wanted to go: "I wanted to go only to the University of Chicago, where Stigler and Friedman were teaching and conducting research. ... My thought at the time was that this would enable me to 'steal' knowledge from them, but I subsequently realized that I had to contribute to the interchange of ideas to enable me to learn from others" (Scholes 2009a, 238-239).

Working as a computer programmer at the University of Chicago, Scholes assisted professors in developing research design. Some of his first clients were Merton Miller and Eugene Fama. "They became my mentors, shaping my understanding of finance. And, fortunately, both became lifelong friends" (Scholes 2009a, 240).

After earning his Ph.D., Scholes taught at MIT, where he met and began collaborating with Fischer Black on financial economics. A little over a decade later, he returned to the University of Chicago, where he focused on taxation (Scholes 1998). Since 1983 he has been on the faculty at Stanford University.

Early on in his life he became fascinated with the stock market, and this interest would lead to his Nobel Prize-winning work (Scholes 1998). Along with Robert C. Merton, Scholes won the 1997 Prize "for a new method to determine the value of derivatives." Most of his work is technical, but Scholes has made policy-related comments in interviews and debates, and he seems mostly to favor free markets.

Along with Fischer Black—who would most likely have been a co-winner had he still been alive—Scholes developed the Black-Scholes formula for pricing stock options. Toni Whited summarizes:

Scholes's contribution to the formula was the logic used to solve the equation—logic that is still taught to students studying finance. Black and Scholes noted that the differential equation did not involve the expected return on the stock and that, therefore, any expected stock

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return is consistent with the option price, including the risk-free rate of interest. (Whited 2008)

In Scholes's words, the equation "prices options on common stock and provides a methodology to value options on securities generally. It can be used to measure risk and transfer risk" (Scholes 2009b).

Scholes's work also included testing the capital asset pricing model and analyzing optimal responses and effects of taxation (Whited 2008).

Scholes's work on derivatives set him up for criticism in the wake of the 2008 financial crisis, but Scholes says, "I haven't changed my ideas" (Scholes 2009b). An article in *The Economist* magazine cites Scholes as a continued proponent of derivatives:

But derivatives have defenders too. Used carefully, they are an excellent—some would say indispensable—tool of risk-management. Myron Scholes, another Nobel prize-winner, says a ban would be a "Luddite response that takes financial markets back decades." (Economist 2009)

In a panel discussion at New York University, Scholes "didn't exactly accept responsibility, but neither did he give a blindered, Chicago-style defense" (Fox 2009). He favored deleveraging, but said current deleveraging was failing, as it was driving down asset values, as well. He also said models fail to take fully into account market-wide risk: "Risk aggregation is not linear. It's nonlinear" (quoted in Fox 2009). Scholes did, however, strongly react against the idea of a global regulator: "If we internationalize everything, we end up with rules that stifle freedom and innovation" (ibid.).

In a 2008 debate with Joseph Stiglitz organized by *The Economist*, Scholes supported the proposition that heavy regulation would be a mistake in the wake of the financial crisis, advocating light regulation instead: "[C]apital requirements and pricing flexibility are the correct way to regulate banks going forward." Scholes argued that market failures "do not lead to the conclusion that re-regulation will succeed in stemming future failures. Or that society will be better off with fewer freedoms." Proponents of heavy re-regulation, he said, "fail to account for the vast increase in the wealth of the global economy that has resulted from the freedom to innovate" (Scholes 2008).

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Theodore W. Schultz

by E. C. Pasour, Jr.⁶⁷

Having grown up on a 560-acre farm in South Dakota, Theodore Schultz (1902–1998) maintained his farming roots throughout his economics career (University of Chicago 1998). His early work on the economics of U.S. agriculture was published mainly between 1932 and 1951 (Gardner 2006, 326). This work laid the foundation for his later work in economic development and human capital, particularly in agriculture, for which he was awarded the Nobel Prize (W. Arthur Lewis was a co-recipient). Schultz is the only agricultural economist to be awarded a Nobel Prize in economics.

Schultz stands out among Nobel laureates in economics in terms of his pre-college formal education. He completed elementary school but never went to high

67. North Carolina State University, Raleigh, NC 27607. I appreciate the help of Hannah Mead in providing valuable references and preliminary work. Dale Hoover and Loren Ihnen also provided helpful comments.