

Remarks in Honor of Ernst Fehr

Distinguished CES Fellow 2013

Klaus M. Schmidt, University of Munich

Munich, November 19, 2013

Mr. President, Hans-Werner, previous CES prize laureates, colleagues and students, ladies and gentlemen, dear Ernst and Helga,

It is both a pleasure and an honor to be giving this laudation for Ernst Fehr on the occasion of his receipt of the Distinguished CES Fellow Prize.

Let me start with a few facts and numbers:

- Ernst is Professor of Microeconomics and Experimental Economics at the University of Zurich since 1994.
- He has written five books and more than 150 published articles. Of these, 24 are published in the top five journals in economics. Another 17 are published in Nature and Science.
- Some of his papers belong to the most often cited papers in economics over the last 20 years.
- Ernst has been president of the European Economic Association and the Economic Science Association.
- He is a member of five academies of sciences and received several major science awards.

With this record he clearly is one of the most distinguished economists of his generation.

But who is the person behind these numbers? What is driving his research? I first met Ernst 25 years ago, in the fall of 1988 at the London School of Economics. He was an Austrian postdoc visiting the LSE from Vienna while I was a PhD student in an exchange program from the University of Bonn. We both participated in Ariel Rubinstein's graduate course on game theory together with other exchange students like Pierre-Paolo Batigalli, Tore Ellingsen, Georg Nöldeke, and Monika Schnitzer all of whom made successful academic careers thereafter. While the rest of us were fascinated by the rigor and intellectual brilliance of game theory, Ernst was more cautious and more skeptical. Can standard game theory really explain actual human behavior? What shall we make of a theory that is refuted frequently by very simple economic experiments? We had long discussions on these issues in which Ernst criticized game theory while I defended it.

At the time, Ernst was an economic theorist. He wanted to understand how the labor relation works and why there is involuntary unemployment. He had built himself a reputation as a promising theoretical labor economist, but he was not satisfied, neither with

the neoclassical methodology nor with the theoretical results offered by his field. Something was missing.

George Akerlof and others had pointed out that fairness and reciprocity are crucial for the understanding of the labor relation. However, these ideas played hardly any role in the labor literature of the time. There was no sound economic evidence that could be used to measure and evaluate these effects, nor was there a theoretical framework to think about them. Ernst went out to change this.

Together with his brilliant students Georg Kirchsteiger, Arno Riedl, Simon Gächter, and later Jean-Robert Tyran and Armin Falk he conducted experiments on gift exchange in labor markets. Using the experimental methodology he showed rigorously that most people are conditional cooperators. If they are treated fairly they are willing to give up own resources in order to reciprocate. But they are also willing to spend money in order to punish others who hurt them.

Starting with the Fehr, Kirchsteiger and Riedl paper in the QJE 1993 there is sequence of highly influential experimental papers in which Ernst and his coauthors develop this idea. They have shown that concerns for fairness and reciprocity can explain many labor market phenomena, including wage rigidity, money illusion, and involuntary unemployment.

The change of Ernst's career is quite remarkable. There was nothing to prepare him to become an experimental economist. At the time, experimental economics was a small niche, and Ernst had no connections to the few people working in this field. When he became a tenured professor at the University of Zurich in 1994 he got the resources to build up his own lab, but he had to do everything from scratch.

I met Ernst again in 1996. He told me about his experiments on gift exchange, on the voluntary provision of public goods, and on bargaining games showing that many (but not all) people seem to be strongly motivated by fairness concerns when they interact in small groups. But, the same people behave very selfishly when they interact on competitive markets. How does this fit together? We jointly developed a theory of inequity aversion that can explain these regularities and that has become a workhorse in the experimental literature on social preferences. This was also the beginning of a long friendship and a very fruitful cooperation. We did many joint projects on incomplete contracts, on optimal job design, on employment as an authority relation, and so on.

Working with Ernst is a real pleasure. He is always working on several dozen projects at the same time. The projects with me are only a tiny part of his overall research portfolio. Nevertheless, when we work together I always have the impression that the only thing in the world he is interested in is our joint paper. When I call him, he is very relaxed and always happy to chat a bit longer. He is very amiable, but make no mistake: When he is convinced that he is right he does not take "No" for an answer. He will come up with the smartest experimental design giving causal evidence to prove his point.

When Ernst wants to show that an effect is real, he does not shy away from practical problems either. He did high stakes experiments in which subjects could earn three times their monthly wage in Russia. He did experiments - jointly with the anthropologist Joseph Henrich and other coauthors – on fairness in bargaining behavior in small scale societies. These involved indigenous people such as the Machiguenga in the Amazon jungle who seem to come closest in their behavior to the model of homo oeconomicus or the Lamelara on remote Pacific islands who are extremely concerned about fairness.

All of this would have been enough to earn Ernst fame and distinction in the profession, but Ernst did not stop there. In the early 2000s he became one of the pioneers of “neuroeconomics” a completely new field in which economists and neuroscientists collaborate to better understand the processes in the brain that govern human behavior. For example, using neural imaging techniques such as fMRI Ernst and his collaborators could show that “punishing an unfair opponent” generates “utility” in the brain in the sense that the same areas in the brain are activated that are also active when a subject experiences other pleasures (like eating a piece of chocolate). This suggests that people really do have “social preferences” that affect their behavior.

This laudation would be incomplete without reference to Ernst’s remarkable successes as an institution builder. He received offers for professorships Bonn, Mannheim, Oxford, Cambridge, Berkeley, Princeton and New York University. Nevertheless, he stayed in Zurich and transformed this place into one of the leading economics departments in Europe and one of the very best centers for experimental, behavioral and neuroeconomics in the world. Today Zurich is attracting star researchers giving up tenured positions at the best universities in the US in order to work at the University of Zurich.

Of course, this success requires a lot of money, and it certainly helps that the University of Zurich is located, well, in Zurich. However, even in Switzerland Ernst’s success is unheard of. Last year he convinced the Swiss bank UBS to make a donation of 100 million Franks to fund five new chairs in economics. A donation of this size to promote basic social science research is unique in Europe. I hope that it sets an example for other private donors, not just in Switzerland.

Dear Ernst, let me conclude this laudation by congratulating you for receiving the Distinguished CES Fellow Prize 2013 and by thanking you for being such a great source of inspiration, not just to me but to an entire generation of young behavioral and microeconomists.

Thank you all for your attention.