

3 Americans Win Nobel For Stock-Price Theory

The Nobel Memorial Prize in Economic Science was awarded to three Americans whose pioneering work helped explain how prices for corporate securities are established in financial markets.

The three winners are Harry M. Markowitz of the City University of New York, William F. Sharpe of Stanford University and Merton Miller of Chicago.

Collectively, their theories explain how risks and rewards can be balanced in a given investment portfolio; how this weighing of risks and rewards helps determine securities prices, and how factors like tax changes or bankruptcy affect the price of a company's securities.

These theories have widespread applications today. For example, they are used by investment firms to predict stock prices and to pick securities for a customer's portfolio. They are used by corporate-finance experts to value potential acquisitions and to make decisions on dividends and financings.

Governments use them to assess the potential impact of a tax change on a given sector of the economy. And a public utility commission might use them to set prices that will enable an electric company to realize a fair return on its investments so it can continue to afford to build the power plants a community needs.

Dr. Markowitz developed the so-called theory of portfolio choice, which analyzes how wealth or savings can be optimally invested in assets that differ in terms of their expected return and risk. While investors might use his formula to choose a portfolio of stocks that yielded the highest possible return with the lowest possible risk, they might also use it to take higher risks in return for a higher profit.

Dr. Markowitz first published his theory in 1952 in an essay entitled "Portfolio Selection: Efficient Diversification."

Investment managers and academic economists had long been aware of the necessity of taking potential returns as well as risks into account in making investment decisions and of the value of

diversifying investment risks. But Dr. Markowitz provided a formula for doing so.

Dr. Sharpe then took Dr. Markowitz's theory to develop a model for explaining how securities prices are established in the market to reflect risks and potential returns.

His theory, which is called the Capital Asset Pricing Model, is now widely used by investment firms to predict how a given stock, for instance, will perform in relation to the stock market.

Dr. Miller is widely considered the dominant force in theoretical and empirical analysis in corporate finance. He was awarded the economics prize for his theory of corporate finance and the evaluation of companies on markets.

His theory explained the relation, via the capital markets, between the capital asset structure and dividend policy of manufacturing companies on one hand and their market value and cost of capital on the other.

Dr. Miller developed the original theory in the late 1950s and 1960s with Franco Modigliani, the professor at the Massachusetts Institute of Technology who won the economics prize in 1985.

(Courtesy International Herald Tribune)

Unity Expected to Slow German Growth

An economic report stirred controversy in Germany by predicting that the country's economy will slow, inflation will rise and unemployment will surge as a consequence of the country's unification.

The forecast contrasted sharply with that of the government, which has predicted growth next year of 2 to 3 percent.

Five leading German economic research institutes said in their report that despite fears across Europe that unification would create an economic juggernaut, Germany's economic growth is likely to slow to just 1.5 percent next year from 2 percent in 1990.

Inflation will increase to 4 percent next year from an estimated 2.5 percent this year, the institutes said in their 80-page autumn report, attributing 0.5 percent of the expected increase to higher oil prices.

Unemployment is expected to increase to 10 percent from 6 percent. In fact, nearly half of eastern Germany's work force may become jobless or have curtailed work weeks by next year, the report said.

Germany's economics and finance ministers issued a joint statement saying that the report's unemployment prognosis for eastern Germany is too pessimistic.

Economics Minister Helmut Haussmann and Finance Minister Theo Waigel said investment in east Germany will quickly lead to the creation of new jobs.

But the report said that while production and demand in the former West Germany would continue to rise, higher spending to rebuild the economy in former East Germany would damp the effect.

"The economy in Germany is split," said Heiner Flassbeck of the DIW Institute. "Eastern Germany is undergoing a deep structural crisis with its markets cut off. Western Germany has increased its markets and the economic boom will continue."

The report predicted that economic growth in the west will drop from 4 percent this year to 2.5 percent in 1991, and that output in the east would fall by 10 percent, after a drop of 15 percent in 1990.

The institutes did not forecast any recovery in the east before the middle of next year, whereas the government has been counting on an improvement by spring.

Eastern German markets have been flooded with western imports and the once state-controlled East German companies, unable to compete.

With nationwide legislative elections six weeks away, the report also touched on the politically sensitive question of tax increases, warning that a tax increase would be inevitable if increases in salaries and retirement payments in the east continued at their current rate.

The report is published by the DIW German Institute for Economics in Berlin, the HWWA Institute for Economic Research in Hamburg, the IFO Economic Research Institute in Munich, the Institute for World Economics in Kiel and the RWI Economic Research Institute in Essen.

(Courtesy International Herald Tribune)