



**Ed Lazear –**

**The Jack-of-All-Trades in Labor Economics**

Laudation for

IZA Prize Laureate Edward P. Lazear

by

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CHECK AGAINST DELIVERY

It is a great honour and pleasure for me to give the laudation on this year's IZA-Prize Winner, Ed Lazear, tonight. I have known him from his literature for 20 years, so I am the generation of researchers that literally grew up with all his inspiring and path-breaking contributions to labor economics. As a more senior researcher I was lucky to have worked with him as a co-author, and the fact that I – being a business economist and not a traditional labor economist - am giving the laudation tonight tells you a lot already about the merits of Ed Lazear's work. He is not only building models that provide new theoretical insights, he also lays great emphasis on them being applicable to today's vital business problems. However, the best characterization of Ed Lazear that I can think of stems from himself, from one of his most recent papers on the origins of entrepreneurship. He differentiates a jack-of-all-trades who rationally decides to become an entrepreneur, and a specialist who is better off working as an employee. Ed Lazear unmistakably is the jack-of-all-trades himself, equipped equally well with many different skills and thus having decided to become an entrepreneur in his field. He is certainly not the employee type of person with a few specialized talents, who specializes ever further, drawing from just one talent for the rest of his life. He is not the researcher who incrementally changes variable after variable, paper after paper; rather, he builds new models and prefers to tackle ever new and socially important questions. Or in his own words "I am good at starting things, but I get bored quickly when it comes to routine work". Once he finishes a paper on one of his intriguing ideas, he rapidly moves on to the next idea, and leaves the field and detailed work for generations of labor and business economists to come. Of course, I can only mention a fraction of his work to give you a small impression of what I mean, but I am confident in the end you will share my admiration for this exceptional scholar.

Ed Lazear has published nine books and approximately one hundred papers, most of which are published in one of the top-journals in economics. One of his first papers, actually the paper he got tenure for, is on "Why is there Mandatory Retirement?" published in the Journal of Political Economy in 1979. The idea basically is that companies pay their employees less when they are young and more when they are old, because it serves as a motivation device. And to make sure that the company doesn't have to pay ever higher wages for ever, they need mandatory retirement rules. From the title, the paper may look like a paper on retirement policies, but what it really is, is a path-breaking and probably one of the first papers on implicit incentive pay in a world with asymmetric information, shirking and incomplete contracts. Later on, these questions have been studied in a zillion of papers by others, but the main ideas were laid out here.

A second strand of research for which Ed Lazear was one of the founding fathers is the so-called “tournament theory”. The seminal paper “Rank-Order Tournaments as Optimum Labor Contracts” was published in 1981 in the *Journal of Political Economy*, together with Sherwin Rosen, one of today’s economists that Ed Lazear admires greatly. The paper addresses the relation between compensation and incentives in the presence of costly monitoring. One of the implications is that paying workers on the basis of rank orders may be superior than paying by absolute standards as this substantially lowers the costs of measurement as well as the nature of risks borne by the workers. This helps to explain why we often observe compensation schemes that vary pay according to the hierarchical level rather than on actual output. Thus, large salaries of executives are not a compensation for the actual value of their marginal productivity, but they are meant to provide incentives for all individuals in the firm who, with a lot of effort, may win one of the few top positions some day in the future. So for example, if Ed Lazear gets his well deserved 50.000 € cheque for the “IZA-Prize in Labor Economics” tonight, it is not a compensation for giving a 30 minute prize lecture later on. It is the winner’s prize in a tournament of labor economists that serves as an incentive to a whole generation of young economists to move into the field and to work hard in order to increase their chances of winning this prize. The tournament idea was again a sparking idea, and legions of labor economists have worked on further specifying tournament models, and more recently on empirical tests of tournament theory. In 1989, Lazear added another idea in his paper on “Pay Equality and Industrial Politics” published in the *Journal of Political Economy*. He showed that when workers’ rewards are based on relative comparisons (as is the case in tournament based pay) a compression of wages across hierarchical levels reduces uncooperative behaviour that may otherwise become detrimental to the firm. Within the same framework he is able to show that firms rationally take personality into account when hiring workers, and that pay schedules based on relative comparisons are more of a problem at higher levels of the hierarchy because these jobs tend to have an abnormally high proportion of competitive individuals. The problems of uncooperative behaviour in tournaments have quickly become a major research issue, whereas the sorting effects of compensation schemes have been ignored for a long time - and are probably still among the most under-analyzed effects in incentive pay.

Then, in 1992, after a couple of other seminal papers, Ed Lazear started a whole new research field, which he then called the New Economics of Personnel. Once asked in an interview on how he got into personnel economics, he answered in a way that is very typical for Ed Lazear, so let me quote him here.

He said:

“It started with the students I had to teach in a business school. If you think about what students care about when they are studying and what they were getting historically, the two were somewhat disconnected. What we taught our students was not necessarily what *they* needed to know; but what *we* knew and what *we wanted to study*. That’s what motivated me when I was a young scholar moving into this area of personnel economics. (...) I started working in the area in large part as a reaction to our business students, who were saying “give us something that is substantive, don’t give us the stuff that is sort of up there in the clouds - even though it may be bright, even though it may be interesting, it is not exactly relevant to what I as a manager plan to do”. So, the field really developed primarily in business schools as a response to the demand by students to give relevancy to the literature.”

Since his first article in the field on “Performance Measurement, Evaluation and Incentives” in 1992, and particularly since his Wicksell Lecture Series in 1993 - later on published as a book by MIT-Press introducing the name “Personnel Economics” with its title - the field has been one of the fastest-growing and most successful fields in labor economics as well as in business economics - the field where I come from. In business economics we, the personnel economists, started as a small minority in the early 1990s, all of our business colleagues being very suspicious about whether economics could help us solve real world business problems, and particularly the ones in human resources management. But thanks to Ed Lazear and his path-breaking contributions on a large number of HRM problems, we are one of the strongest and most research-oriented fields in business economics today.

But it wouldn’t be Ed Lazear if he had stopped at that point. He never stops generating new ideas. More recently he has published in top-level journals on “Culture and Language”, on “Economic Imperialism”, on “Educational Production and Class Size”, on “Teacher Incentives”, on the “Peter Principle” and on “Entrepreneurship”. And there are even more new ideas in the pipeline, such as the “skill weights approach on firm specific human capital” or “speeding, tax fraud, and teaching to the test”.

But Ed Lazear doesn’t only produce research papers and teach business students. He has also served a great deal to the scientific community of labor economists. He is founding editor of the Journal of Labor Economics, he was a founding father and president of the Society of Labor Economists, he has given literally hundreds of talks and many honorary lectures and keynote speeches around the world. He has also been active as an advisor to the government - at home and around the globe – and he is a businessman himself. He has founded one of these

typical silicon valley start-up companies, which did not only survive the boom years of the new economy, but also the years after the bubble crashed, so obviously his theories and thoughts even survived the hardest real world test.

And Ed Lazear is a great teacher, not only to his graduate and doctoral or executive students at Stanford university, which awarded him the distinguished teaching award in 1994, but also to numerous Ph.D. students abroad, where he taught and organized a broad range of courses in labor and personnel economics for Non-US Ph.D. students. But he is not only teaching them in class, he always spends a lot of time with them on discussing their research projects and advising them individually. Knowing quite a few of the students, who participated in one of the courses he taught in Europe over the years, there is one more aspect I can add from their personal experiences. They are all not only enthusiastic about how much they have learned from him, but also about his wonderful personality. Inarguably, he is Chicago-style, very tough and uncompromising when it comes to economics, but on the personal side, he is always encouraging, nice and friendly in his tone. So it never comes as a surprise to me when young researchers tell me they met Ed Lazear at one of these hard work-seminars, but they sound more like they have just joined a new fan club, than having worked really hard for a couple of days.

To cut a long story short: Ed Lazear, you are the perfect IZA-Prize laureate, you have contributed major theoretical ideas to labor economics; with ‘personnel economics’ you have started a whole new research field, you have trained a whole new generation of labor economists, and you have remained a wonderful person despite being busy, busy all day long, all year round.

Congratulations!