

Our very own Dr. Joe Stiglitz “brought home the bacon”!
October 10, 2001

This morning the Nobel prize in economics for 2001 was given to Dr. Joe Stiglitz of Columbia and FOLIO*fn*, Dr. George Akerlof of UC Berkeley, and Dr. Michael Spence of Stanford. This document will shed some light on why they won it. I have had the privilege of knowing two of them personally; Akerlof was my mentor at UC Berkeley and Stiglitz has worked with the research group at FOLIO*fn* for almost one year now.

What did these men contribute to the field of economic sciences?

All three men did work in the theory of economics associated with “*asymmetric information*.” What does that mean? It means that there are many situations in economic transactions where one party has different information than the other party.

For instance, **Akerlof** wrote a paper when he finished MIT entitled: “The Market for Lemons”. In that paper, he showed how the used car market could become very thin, just due to the fact that the used car sellers had better information about the cars than the used car buyers. This could lead to “bad cars” or “lemon cars” driving out the good cars until the entire used car market disappeared (or at least was smaller than it should be). All this occurred just because of the differing information between the buyers and the sellers.

Michael Spence was one of the economists people said would win the Nobel prize just for his graduate thesis. This thesis involved “asymmetric information” as well. It was the role of signaling as a means to reduce this differing information. In fact, my “extreme” view of his work could be described as follows. Higher education doesn’t improve one’s skills at all in the market. Take my assumption as given. If that’s true, why do people go to college/grad school? Spence would call it a signal. You want to say, “Hey, I made it through Harvard’s math program, even though it doesn’t help me manage Microsoft. By going through the program, though, I have signaled to you that I’m smart, not dumb. So don’t worry that I have more information about my ability than you. I’ve just shown you that I’m smart.” So his work revolved around “signaling as a means to resolve the asymmetry that hampered markets.

Note: I didn’t put Spence in my prediction because he really hasn’t done any new work since his thesis. But I’m glad, because it shows that even one piece of good work is well rewarded.

Joe Stiglitz took the other route. He showed how people with “less information” could extract that information by using clever contracts. For instance, in the insurance industry, they offer different deductibles to get around this “asymmetric information problem.” Joe also wrote a paper with Shapiro on shirking workers. How employee effort, being better known by the employee than the employer can lead to specific outcomes, such as higher than average unemployment as an equilibrium.