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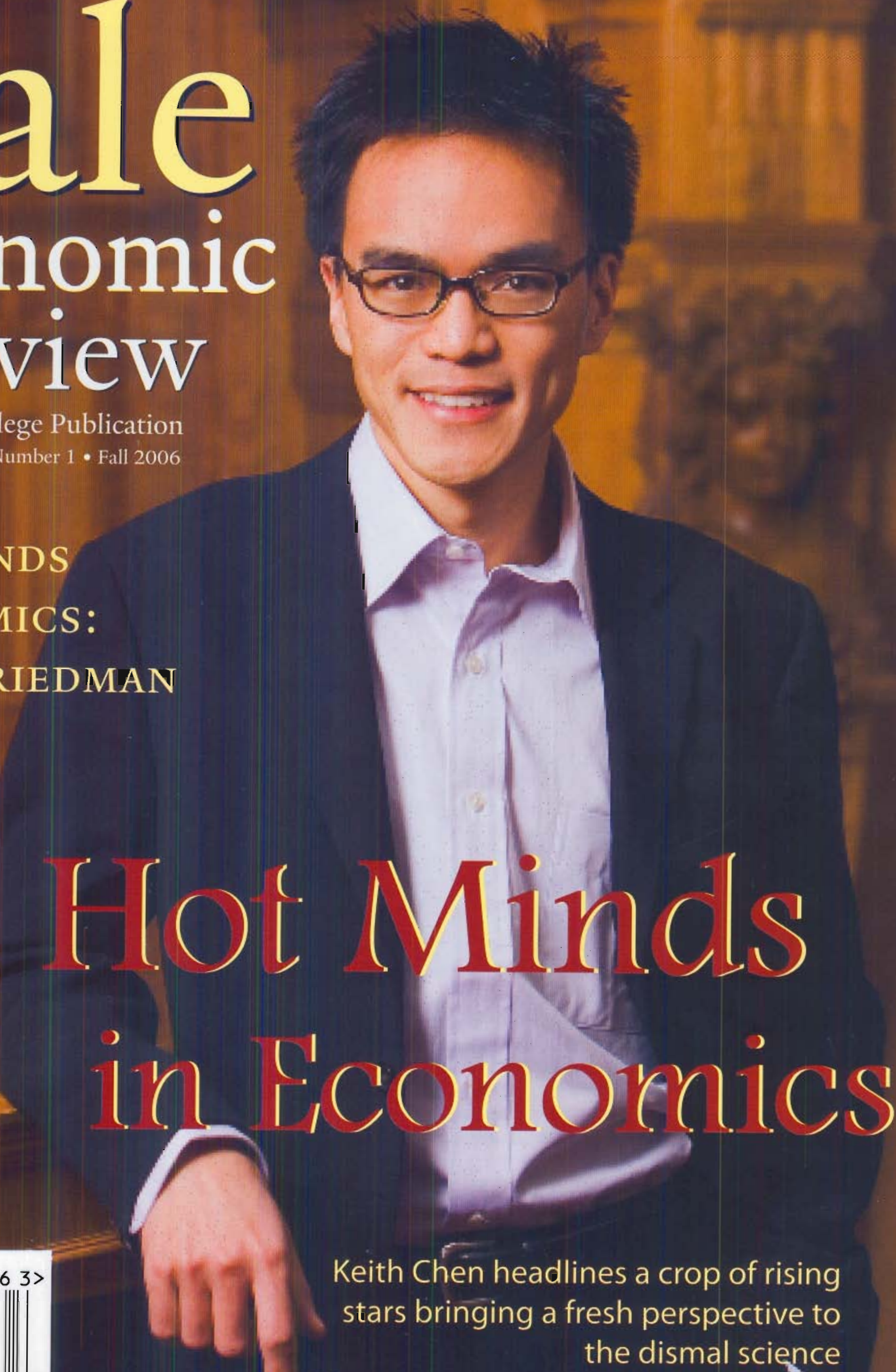
Yale Economic Review

A Yale College Publication

Vol. III Number 1 • Fall 2006

GREAT MINDS IN ECONOMICS: MILTON FRIEDMAN



5 Hot Minds in Economics

Keith Chen headlines a crop of rising stars bringing a fresh perspective to the dismal science

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PLUS ARTHUR LAFFER AND ROBERT SHILLER

Young Guns:

From the streets of New Haven and Cambridge to the hills of Princeton; from the frost of a Wisconsin winter to the heat of a Czech Republic summer – the next generation of economists has arrived. M. Keith Chen, Rohini Pande, Markus Brunnermeier, Laura Schechter, and Thomas Sedláček – none of them a day over 40 – are among the bright stars rising to prominence in the field. They may not be superheroes, but these five young economists have launched an attack on the discipline's staid reputation with a repertoire of unconventional ideas.

With backgrounds as diverse as their topics of study, each brings a fresh perspective to an established body of research – Chen on the evolutionary basis of human behavior, Pande on public policy in developing nations, Brunnermeier on behavioral finance, Schechter on trust, and Sedláček on reforming a communist economy. Their work has touched the United States, the Czech Republic, India, and Paraguay. They have experimented with monkeys, worked with the Federal Reserve Bank of New York, and advised presidents. While these five may not be household names, their work is already turning heads.

5 Hot Minds in Economics

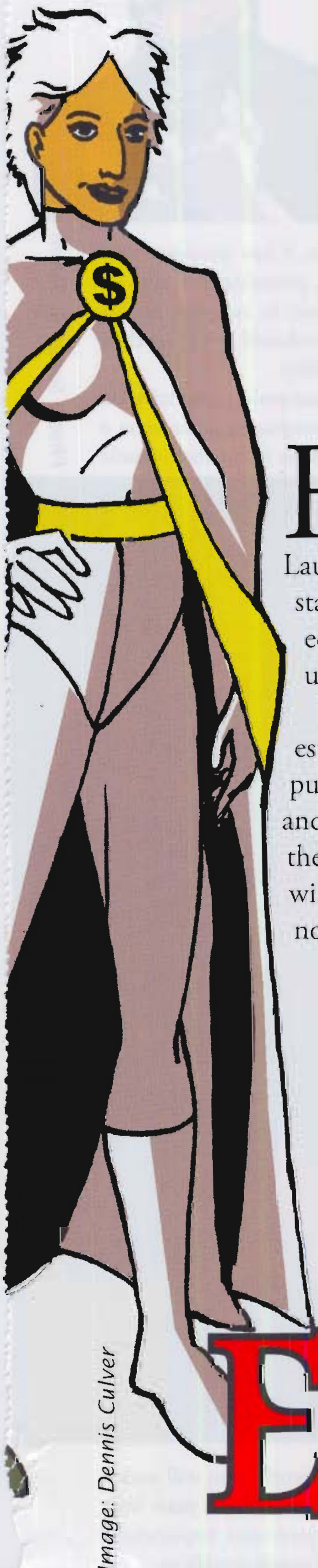

Image: Dennis Culver

Laura Schechter

Assistant Professor of Economics, University of Wisconsin

To the list of traditional themes in economics—profit, efficiency, and competition, among others—Laura Schechter wants to add one more: trust. But investigating such a subtle subject often requires innovative methods. Just 31-years-old, this Assistant Professor of Agricultural and Applied Economics at the University of Wisconsin-Madison sets herself apart with both humanitarian interests and inventive research techniques.

Schechter's dissertation, "Trust, Trustworthiness, and Risk in Rural Paraguay," highlights this approach. "I was really trying to study two things," she explains. "First, how important trust is for economic outcomes? Second, what are the mechanisms through which trust affects economics?"

To study such a large-scale issue, Schechter focused on the micro-economy of farmers in rural Paraguay. Her interest in the area stems from experience working there as an agricultural extension volunteer with the Peace Corps from 1996 to 1998. "Laura deserves the recognition that few students can claim of studying a real problem that was suggested by field experience," praised Elisabeth Sadoulet, a professor at Berkeley who worked with Schechter on the thesis.

Schechter's two years spent volunteering made her realize "how important trust really is." She ultimately found that expectations of theft strongly deterred farmers from investing in more profitable crops. She puts it succinctly: "If you have untrustworthy neighbors, you don't plant crops you might otherwise plant."

Direct exposure to the plight of the farmers drew Schechter back to Paraguay a second time. This time, however, she returned as an academic, albeit with very little to show for it: three locally-hired enumerators, a Mitsubishi pickup truck, and a driver. "Getting funding was a big difficulty," Schechter recalls. "We ran the experiment in a school room or a community meeting room, and we picked the farmers up if they wanted. It was much more complicated than an experimental lab—no laptops, all pen and paper, and people with little or no education."

Fortunately, Schechter's creative experimental techniques helped her overcome these obstacles. In addition to utilizing previously-compiled survey data, she engaged farmers in a number of experiments, an approach called "quite innovative" by Sadoulet. Schechter used a traditional trust game to measure trust and trustworthiness, as well as a game she designed herself to gauge risk aversion independent of trust. Ultimately, Schechter identified gift-giving as a means to deter theft among farmers.

Schechter's contributions to ingenuity in economic method continued once she left Paraguay. A 2006 working paper written with George Jude examines testing survey data for abnormalities using Benford's Law, which states that the leading digits of large numbers from real-life sources are usually small digits, most often one. In another study conducted with Julian Jamison and Dean Karlan, Schechter finds that economics experiments that deceive subjects risk altering those subjects' responses to subsequent experiments (see Insights, *page 3*).

Schechter has also studied more general relationships among poverty and risk. "In 2000, the World Bank interviewed hundreds of poor people around the world for their annual development report. They found that the worst thing about living in constant need, according to the world's poor, was the feeling of vulnerability and exposure to risk," said Schechter. In "Measuring Vulnerability," Schechter suggests that susceptibility to risk in addition to measures of income may be a better indicator of poverty than just pure income. Accordingly, she advocates policies that, in her words, "aim to lower the probability of a really bad thing happening, not just alleviating poverty on average." She furthermore believes that policymakers should study the effect of social structures on economic outcomes. According to Schechter, "The impact could be tremendous."

Photo: Tyler Robbins

And she plans to do just that: "I'm going to be researching a lot about social networks in the future," Schechter says. "It would be great if we could take our mathematical and theoretical methods and make them more realistic models of human behavior. Economics is going more and more in this direction."